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PHILIPPINES

ASSISTANCE STRATEGY STATEMENT

(FY 1991 - FY 1995)

USAID/Philippines

March 1990

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I. INTRODUCTION

This assistance strategy for the Philippines specifies how U.S. development resources, in coordination with other donor assistance and private sector investments, will support the development of the newly restored democracy during the first half of the decade of the 90's. The pivotal and unique three-way partnership of the Philippine Government, donors and the private sector, under the umbrella of the Multilateral Assistance Initiative (MAI), provides the context for and opportunity to realize this strategy.

Four years after the 1986 People Power Revolution which restored democracy and open political and economic systems to the Philippines, the nation is at a critical juncture. The impressive economic recovery which occurred between 1986 and 1989 is slowing down, reform momentum has slowed considerably, and political opponents are growing bolder. The combination of worsening economic conditions -- increasing inflation, high interest rates, widening budgetary deficit and an expanding trade gap -- and the coup attempt of December 1989 has recreated a situation in which implementing additional major structural reforms is an urgent priority.

To revitalize the economy, obtain sustainable strong growth and preserve democracy, it is essential that these additional policy actions be sustained over the strategy statement period. Getting the policies right is the single most important thing that can be accomplished, but due to serious neglect of infrastructure and institutional development in the last decade, these too form significant bottlenecks to accelerating private-sector-led growth which must be addressed.

The intention of the economic leadership to move aggressively on this agenda seems clear; its ability to achieve actual implementation of it remains to be seen. There are powerful dissenters, vocal elements of the democratically-elected Congress vociferously oppose key elements, and the 1992 election looms over the entire process. AID's role is to mobilize its resources to support, encourage, leverage, and assist, where possible and as most likely to ensure success, in this absolutely vital undertaking.

This document is somewhat unique. It is one of the last of a breed for the ANE bureaucracy as it it generally follows the traditional CDSS format and criteria, yet incorporates some aspects of the new approaches which are currently being considered in the ANE Bureau and the Agency. The basis of this document is the country strategy agreed upon during the Philippine Program Week in June 1989. However the document also places the country strategy squarely within the context of the more recently articulated Bureau strategy focused on open markets and open societies, sustainability of development efforts and increased economic choice through private sector development. This new Bureau strategic approach is readily applicable to both Philippine political and economic values and to the directions of the USAID/Philippines program, which will over the period covered by the strategy statement fit solidly within the Bureau's new strategic framework.

Strategy

The Philippines Assistance Strategy was agreed to in the June 1989 Philippine Program Week. Since this time the Bureau open markets and open societies strategic framework has been substantially developed, and we have consequently adjusted the goal and five major elements of the strategy to take these developments into account.

The goal for the Philippine Assistance Strategy as modified is: **broad-based, sustainable economic growth through active partnership of the private and public sectors in fostering open and efficient private sector markets.**

The program strategy can be represented by a matrix with the five key programmatic objectives on the vertical axis.

The specific objectives for the strategy are:

1. **a policy and insititutional framework stimulating market-based private sector growth.**
2. **open and competitive markets.**
3. **infrastructure that facilitates expanded private sector activity.**
4. **more efficient delivery of essential services.**
5. **effective and sustainable management of natural resources.**

Three major cross-cutting themes which apply to each of the five programmatic objectives on the horizontal axis of the matrix are:

- **Policy Dialogue**
- **Private Sector**
- **Decentralization**

This document is a consciously streamlined document which by agreement synthesizes and summarizes the numerous sectoral studies which support it and which constitute a very bulky technical annex.

To flesh out some of the key sectoral and policy issues and supplement the extensive body of literature referenced in the bibliography, and following through on the Bureau's suggestions during the 1989 Program Week, several major analytical studies have been carried out over the intervening nine months. These are:

- Private Sector Development Strategy
- Financial Markets Development Strategy
- Transport Sector Review (including Inter-Island Shipping)
- Health Sector Finance Strategy

-- Age Specific Demographic Events in the Philippines
-- Agriculture and Natural Resources Strategy
-- Sustainable Natural Resources Assessment
-- Strategy Assessment: PVO Co-Financing

Private Sector

It is important to single out the importance to our strategy of the private sector and to emphasize its relationship to the overall goal of the strategy. The focus on the private sector as the engine of growth for the Philippine economy is a theme which is deeply ingrained throughout the strategy. It should be recognized that the projects which directly support private sector development are only a small part of this private sector thrust.

First and foremost, the policy dialogue and related performance-based policy support programs are targeted specifically on policy changes conducive to opening up the economy, moving it systematically toward market-determined pricing, reducing artificial constraints to entry, fostering a climate which attracts private investment, and reducing government involvement in activities which belong in the private sector.

Second, we are responding to the most urgently felt need of the Philippine private sector by continuing support for critically deficient infrastructure such as transportation, power and telecommunications.

Third, we are building a solid core of financial sector privatization, trade and investment projects that will directly support private sector development; and through our sector programs such as health and population, natural resources and agriculture, enhancing the role of the private sector in attacking sectoral problems. Across the board, we are expanding the use of the private sector as a means of achieving develoment objectives.

Since the U.S. private sector can also play a major role in terms of technological transfer and innovation, we have focused a portion of the first MAI project, Philippine Assistance Program Support, directly on the private sector and the rest on feasibility studies for the public sector that would be carried out by a combination of U.S. and Philippine private firms. We are anticipating using other MAI funds to leverage substantial investment in power, telecommunications and other key sectors through a mixed or blended credit program planned for FY 1990. As MAI U.S. private sector reconnaissance Mission is being staged in March of 1990 to explore a greater role for the U.S. private sector in the entire MAI program.

The Multilateral Assistance Initiative

The Multilateral Assistance Initiative (MAI) has gotten off to a good start and though still in its first year of implementation, is meeting most expectations. The ODA levels for the first year are largely as pledged, the U.S. shortfall being a notable exception. Since the original consultative group kick-off meeting which launched the MAI Program in July of 1989, there have been two subsequent mini-CG meetings: one on improving the rate of implementation in October 1987, and another, on the environment and natural resources in February 1990. There have been two Core Group meetings to review progress toward meeting the MAI performance targets.

The latest Core Group meeting in Hawaii during March of 1990 focused sharply on the need for the GOP to make significant macroeconomic structural reforms in order to regain the momentum of growth that had been achieved prior to the fall of 1989 and move back into synch with the established objectives of the MAI program. The next Core Group meeting is set for June 1990, where the structural reform prog' am outlined by the GOP at the March Core Group meeting and overall performance will be evaluated.

The MAI framework has proved to be a major move toward improving donor coordination on both the macroeconomic as well as sectoral levels, even if its full synergistic potential is yet to be realized. In the macroeconomic context, it has also provided a forum to facilitate the debt reduction efforts which have produced significant results. In January the GOP concluded a major debt buy-back which reduced private commercial long-term debt by $1.34 billion and in March the latest phase of debt restructuring generated about $711 million in new private bank loans from 83 institutions.

Management Issues

The rapid growth in the overall program level, combined with severe constraints in staffing levels as a result of security concerns, mandates that we find more efficient ways of doing business. To this end, when it is consistent with our strategic development objectives and where there is the requisite institutional capacity in place, we are chosing sectoral performance-based program approaches to meet our objectives. Thus, USAID's strategy and plans for the next five years will show a clear trend toward policy activities and sectoral performance-based programs, with traditional projects representing a progressively smaller share of the portfolio.

In theory -- yet to be proved -- this should require less staff time during implementation, but it is nevertheless apparent that the level of effort required during the design stage is substantially greater than that for projects. As AID develops more experience and the Mission develops a track record in this area we will continue to weigh the options available to more effectively manage the workload associated with the expanded program. It should be recognized that USAID/Manila currently has what is probably the lowest ratio between USDH staff levels and program levels of any AID Mission.

The second section of this strategy statement reviews, within the open markets, open society context, the development challenges facing the economy. Section III discuss the strategy in more detail and sets out an initial iteration of performance indicators for discussion. Section IV summarizes the major sectoral work which has been done to support this document, again within the context of the Bureau strategy. The fifth and sixth sections deal respectively with management issues and topics of special interest.

II. OPEN MARKETS, OPEN SOCIETY AND SUSTAINABLE ECONOMIC GROWTH

A. Overview

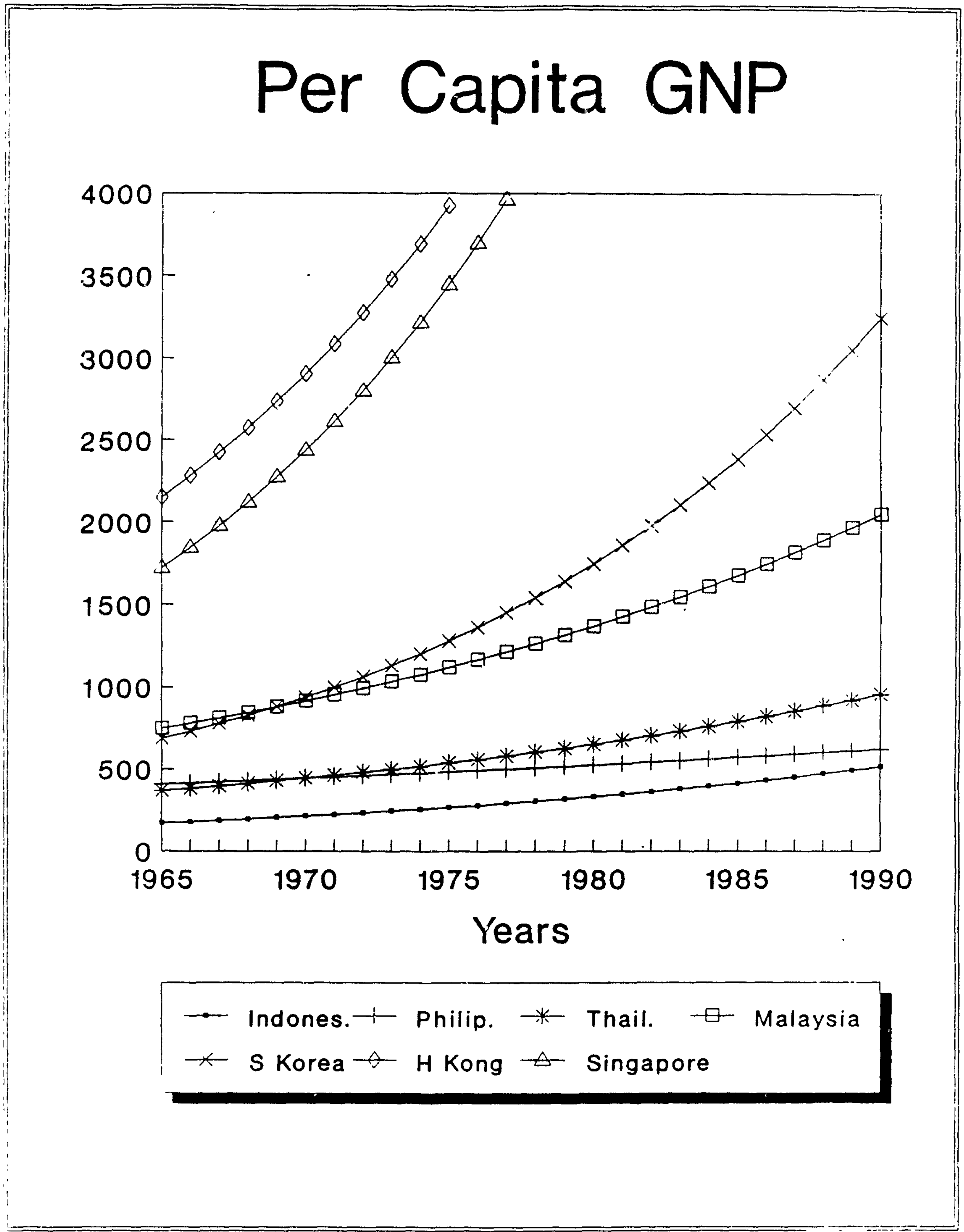
Post-war economic development in the Philippines has been characterized by cyclical economic growth followed by balance of payments crises and accompanying economic stagnation or decline. Unsustainable growth becomes even more conspicuous when the Philippines is compared to other Asian nations.

In the immediate post-war period, the Philippines was one of the most developed nations in Asia. However, despite periods of rapid growth, it has since then grown at a much slower pace than most other East and Southeast Asian countries, especially in per capita terms (See graph). The Philippines' rapid population growth has hampered the translation of economic growth into rising per capita standards of living.

Since the People Power Revolution of February 1986, the Philippines has had one of the most open and active political systems in Asia. Freedom of the press is unsurpassed, restored democratic institutions are functioning, and major elections are freely held. However, this new found openness is under pressures from communist insurgents, Moslem separatists, military adventurers, Marcos cronies, and other dissatisfied elements willing to use extra-constitutional means to obtain power. Perceptions of graft, corruption, inefficiency and lack of direction against a backdrop of transportation and energy shortages threaten to undermine popular support for the Aquino administration and encourage well-financed opponents of democracy to seize power through military actions.

The Philippines has a vigorous private sector and generally open markets. However, the country is hampered by poor supporting trade, exchange rate and macro management policies, weak supporting institutions, biased investment incentives, the burden of parastatals, and excessive regulation. To achieve sustainable economic development and break the pattern of growth and stagnation, the Philippines needs to pursue aggressively a course of further opening its markets and society. Openness is necessary to deal with basic constraints to sustainable growth and to curb population growth.

For the Philippines' open society to survive, improvements in governance, including meaningful decentralization and effective administration of justice; continued strengthening of the voices of profit and non-profit non-government organizations, and the protection of fair elections are essential. Critical to further opening markets are completion of the recasting of the development orientation of the economy through structural adjustment, strengthening of institutions, further trade liberalization, addition of new and protection of existing infrastructure, improvements in the efficiency of essential services, and improved management of natural resources.


Per Capita GNP
4000
3500
3000
2500
2000
1500
1000
500
0
1965
1970
1975
1980
1985
1990
Years
Indones.
Philip.
Thail.
Malaysia
S Korea
H Kong
Singapore

B. Political Setting

The Ferdinand Marcos period (1965-1986) resulted in significant damage to the political institutions necessary for a functioning democracy and an open economy. Those gaining the most were Marcos cronies, who with the support of the dictator amassed immense fortunes. In addition, the military's status grew significantly. The growing communist insurgency further enhanced the military's power and prominence. The 20 years of Marcos rule continue to have lasting negative effects on the political -- as well as economic -- system.

In February 1986 a revolution brought Corazon Aquino to power. A new constitution was ratified, and the legislature and local officials were democratically elected. The Aquino administration has had great success in opening the society and bringing democracy and freedom back to the Philippines.

However, as the six coup attempts, the most recent and serious in December 1989, continuing communist insurgency, and Moslem separatist movement attest, the political situation remains far from stable. The negotiations on the U.S. military bases and the run up to the 1992 elections will create additional stresses on this newly created structure. To safeguard and firmly establish the present political openness of the society, the GOP must improve its governance, including decentralizing government, upgrading the administration of justice, and strengthening the popular perception of fairness within the system. The elections of 1992, a watershed in the democratic process, must again be perceived as completely open. Democratic nongovernment voices must be heard effectively.

C. Economic Setting

The roots of the present economic problems go far back in Philippine history. Philippine economic policies in the 1950s and 1960s placed emphasis on import substitution, particularly in consumer goods industries, and foreign exchange controls. Although these policies did provide growth in the early postwar period, constraints such as the limited size of the domestic market and dependency on imported inputs were restricting growth by the 1960s.

These protectionist policies biased the economy in favor of urban based, capital intensive industries concentrated in Metro Manila. These were not efficient enough to compete on international markets. The economy faced balance of payments crises beginning in the 1950s, and the manufacturing sector's increasing dependence on imported inputs contributed to more of these problems in the late 1960s.

Efforts were made in the 1970s to remedy these difficulties with measures such as an Export Incentives Act, 'managed floating' of the peso and duty-free imports for certain exporters of nontraditional manufactured goods. Despite some success, notably with exports of garments and semiconductors, the basic situation remained unchanged; heavy protection of import-substituting industries slowed and distorted the economic development of the country and compounded the lack of employment opportunities. These underlying trends were exacerbated by the high population growth rate.

While economic growth appeared to be respectable in the 1970s, this was based primarily on foreign borrowing. After the second sharp oil price rise in 1979, the Philippines increased external borrowing to accelerate public spending programs. The Marcos administration intervened heavily in the economy, primarily to the benefit of Marcos cronies. Examples of excessive intervention include the establishment of agricultural monopolies and the public sector's acquisition of formerly private corporations. The resulting inefficiency and corruption had increasing negative effects on the economy which still plague the decision makers and elude easy solutions today.

To deal with the persistent economic malaise, the GOP began structural adjustment programs in the early 1980s to open up markets. However, conditions continued to deteriorate as international market fluctuations and softness in primary commodity prices caused even greater problems. The government accelerated its heavy foreign borrowing to finance the investment-savings gap, which continued to grow. In the climate of global recession and declining availability of cheap foreign funds, the economy first stagnated and then began to contract.

The political crisis which arose from the Aquino assassination in August 1983 triggered a loss in business confidence, massive capital flight, and an abrupt decline in foreign commercial credit. In October 1983 the GOP called a foreign debt moratorium, and the economy registered negative growth rates in GNP in both 1984 and 1985.

In the midst of the crisis, the GOP attempted to revitalize the economy by continuing reform efforts, liberalizing the trade regime and financial sector and improving export and investment incentives. After 1983 the peso was significantly devalued, the public sector deficit was narrowed, and reserve requirements were increased to reduce the liquidity of the banking system. These efforts had only limited impact, however, as crony interests, political expediency and crisis conditions constrained reforms.

Upon its ascension to power in 1986, the Aquino administration returned to the path of economic reform that was initiated in the early 1980s, but subsequently blocked by crises and Marcos cronies. Its early initiatives included import liberalization, dismantling of agricultural monopolies, privatizing government owned and controlled corporations and acquired assets, and emphasizing growth of the private sector, small and medium sized enterprises, and non-metropolitan areas.

Much progress has been made on this reform program. Much also remains to be done. The economy has recovered from negative growth in 1984 (6 percent of GDP) and in 1985 (4.3 percent). It posted growth rates in GDP of 4.7 percent and 6.4 percent in 1987 and 1988. The growth of real GDP in 1986-88 was fueled primarily by growth in domestic demand, but with a growing role for investment and exports.

The rate of progress has slowed considerably, however, and key indicators have deteriorated. The economy's growth slowed in 1989 with the preliminary GDP growth rate figure of 6.0 percent, inflation picked up, and both the budget gap and the gap between exports and imports widened substantially. The degree of damage caused by the December 1989 coup attempt is not yet clear, although it now seems the impact on growth will be less significant than originally feared. Action is urgently needed on reducing the budget deficit, containing inflation, restoring private investor confidence, and improving trade competitiveness. Without bold action to reemphasize sound structural reforms, further opening of markets, and safeguarding of the openness of the society, the Aquino recovery is unlikely to be sustainable.

D. Prospects for the 1990s

Economic and demographic trends provide vital inputs for specifying a development strategy for the country. They form both the context and the substance for issues of sustainable growth, open markets and an open society. Key projections for the Philippines based on the assumption of no further major reforms or programs are:

1. Economic growth over the medium term is expected to decline from a 4-5 percent range toward a 3 percent level, with increasing danger of another balance of payments crisis.
2. The international trade sector will continue to expand, but with imports leading the way.
3. Energy consumption will increase by 6 percent or more a year, with the increasing likelihood of approaching the limits of energy supply in the next year or so.
4. Insufficiencies in rural infrastructure, uncertainty created by the uncertain enforcement of the agrarian reform program, and insurgency are likely to constrain the development of otherwise highly potential agribusiness in the 1990s.
5. From an estimated 62 million in 1990, the population will reach at least 74 million by 2000. The population growth rate is expected to slow in this decade but the corresponding demographic transitions, including the projected reduction in morbidity rates and in the growth of the labor force will lag behind those of many other countries.
6. Urban population is expected to grow at over three percent a year over the decade, with at least two-thirds of this growth outside NCR.

However, with strong policy reforms and substantial investments aimed in particular at energy and infrastructural bottlenecks, the Philippines can dramatically improve these projections. With concerted efforts, sustained growth of 5 to 6 percent and more, with exports gaining on imports and the chances of a balance of payments crisis decreasing, the energy constraint overcome, and the agribusiness potential realized, is possible. Encouraging these reforms is a key objective of USAID/Philippines.

1. Income Prospects

After recovery in 1986 through 1988, the Philippine growth path over the next 3 to 5 years, without continued reforms, is expected to decline from a current 4-5 percent range to a 3 percent level, with an increasing danger of a balance of payments crisis. Any substantial improvement in the country's growth prospects during the 1990s requires further progress on the structural reforms that commenced in the early to mid-eighties. As per capita real income growth slowed to 3.1 percent in 1989 from a vigorous 4.1 percent in 1988, the sustainability of growth has become the utmost policy concern. (See graph). Continued deterioration of the savings-investment gap (3.6 percent of GNP in 1989 from 1.3 percent of GNP in 1987) and inflation rising past the double-digit mark (14.1 percent for December to December in 1989) are telltale signs of unsustainable growth. Another balance-of-payments crisis is likely to occur unless exchange rate and trade policy reforms, combined with fiscal and monetary restraint, are pursued.

2. Openness/Integration with the World Economy

The combined size of the export and import sectors is a measure of the degree of integration of the domestic economy into the world economy. The sum of the ratios of exports and imports to GNP rose from 43.8 percent in 1986 to 51.5 percent in 1989. While the rise in the share of the trade sector is admirable, it can be attributed to the acceleration of imports (from 18.7 percent of GNP in 1986 to 26.4 percent of GNP in 1989) caused by recovery of aggregate demand, initial liberalization of imports and appreciation of the exchange rate. Unless the government continues reforming the economy and stresses a market-determined exchange rate and export promotion, export growth will continue to be surpassed by the rise in imports.

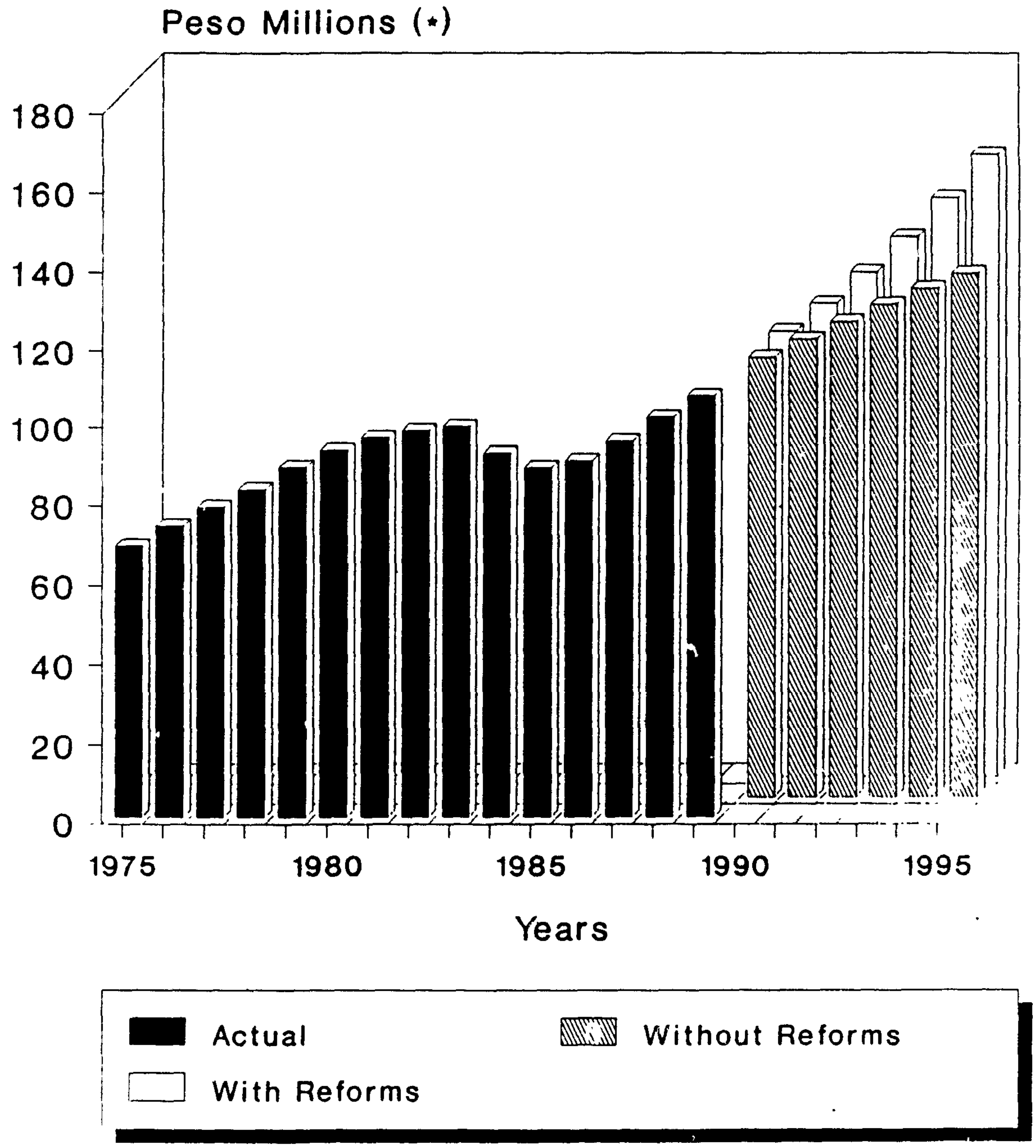
3. Energy Consumption

In the 1986-88 period, energy consumption grew slightly under 6 percent a year. Over the medium-term, it is expected to increase annually by 6 percent or more, if economic growth remains undisturbed. Imported oil supplied nearly 60 percent of the country's annual energy requirements since 1986. Future growth will require a larger domestic capacity to generate energy and electricity, particularly in the Luzon grid.

4. Agribusiness

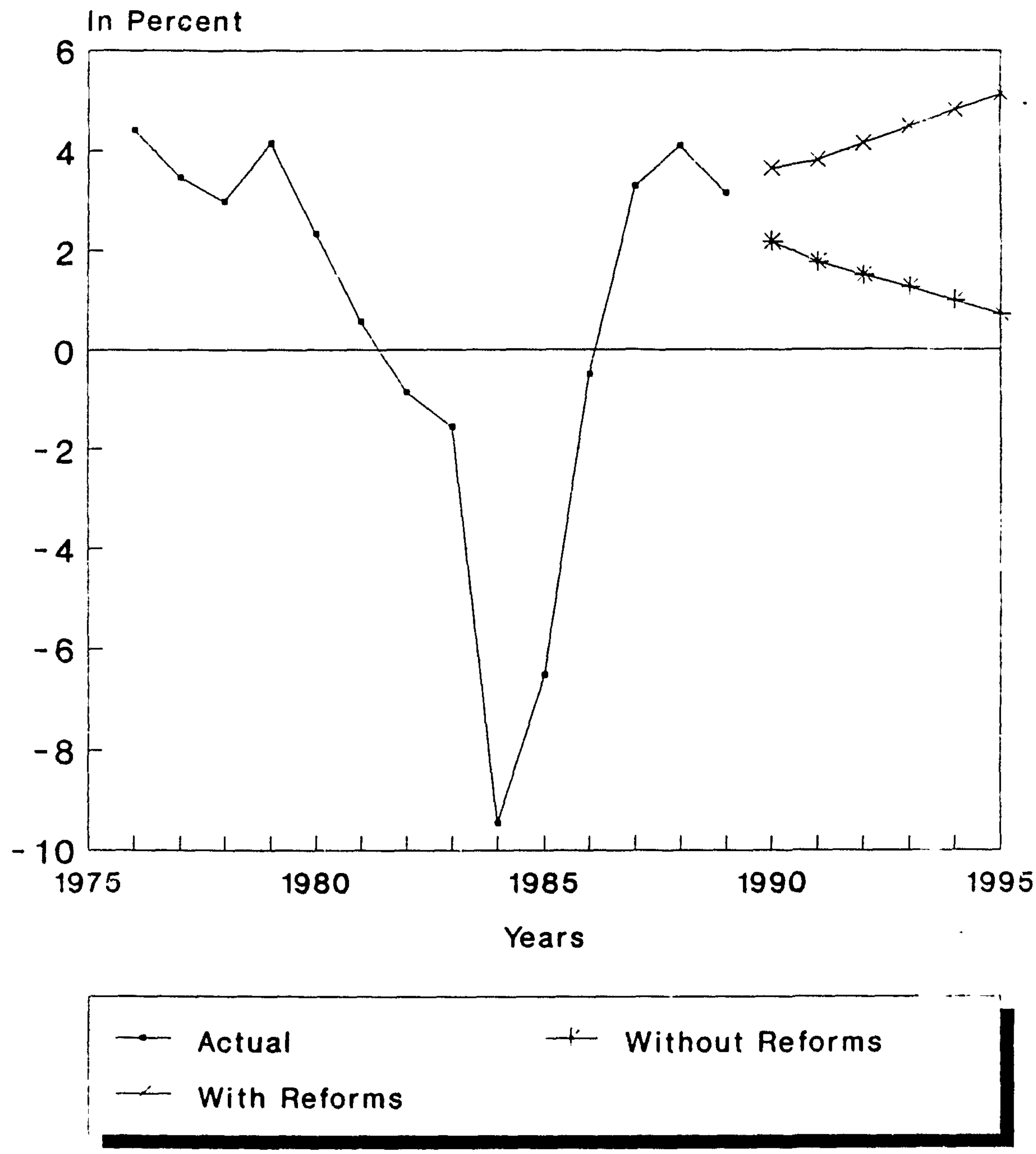
Three major constraints to realizing the potential for agribusiness in the Philippines are: uncertainty being caused by the uneven implementation of the Comprehensive Agrarian Reform Program (CARP), insufficiency of rural infrastructure particularly in transport and irrigation, and the insurgency movement. Because of the CARP, agribusiness proponents may well shy

REAL GNP: PHILIPPINES
At Constant Prices



* - At 1972 Prices

PER CAPITA REAL GNP: PHILIPPINES
(Growth Rates)



away from big-plantation farming, and only after the distribution of lands, adopt contract-growing and nucleus estate farming. Addressing the infrastructure and peace and order issues, along with government reforms aimed at removal of policy biases against agriculture and related activities and liberalization of rules on foreign investments, would boost investments in agribusiness in the 1990s. Private forecasts of the growth of agribusiness output ranges from 3.5-4.0 percent in the period 1990-95.

5. Demographics and Health

Some demographic trends that either support or are implied by the population estimates for the year 2000 are:

- Continued decline in the total fertility rate from 5.92 in 1970 to 4.96 in 1980, 3.73 in 1990 and 2.84 in 2000, and in the population growth rate. (See graphs.)
- Modest improvement in life expectancy from 64.5 years in 1990 to 66.9 years by 2000.
- Pace of the change in demographic composition is expected to be slow, with the median age increasing from 19.9 to 22.4 years from 1990 to 2000.
- The morbidity pattern will change somewhat from 1990 to 2000. However, the ranking of incidence of specific diseases is not expected to change. Projected morbidity for the age group 0-14 is 61.4 percent in 1990, declining to 56.8 percent in 2000. Under optimistic population and morbidity rate assumptions, the projected morbidity for reported diseases is expected to decline by 9 percent from 1990 to 2000.

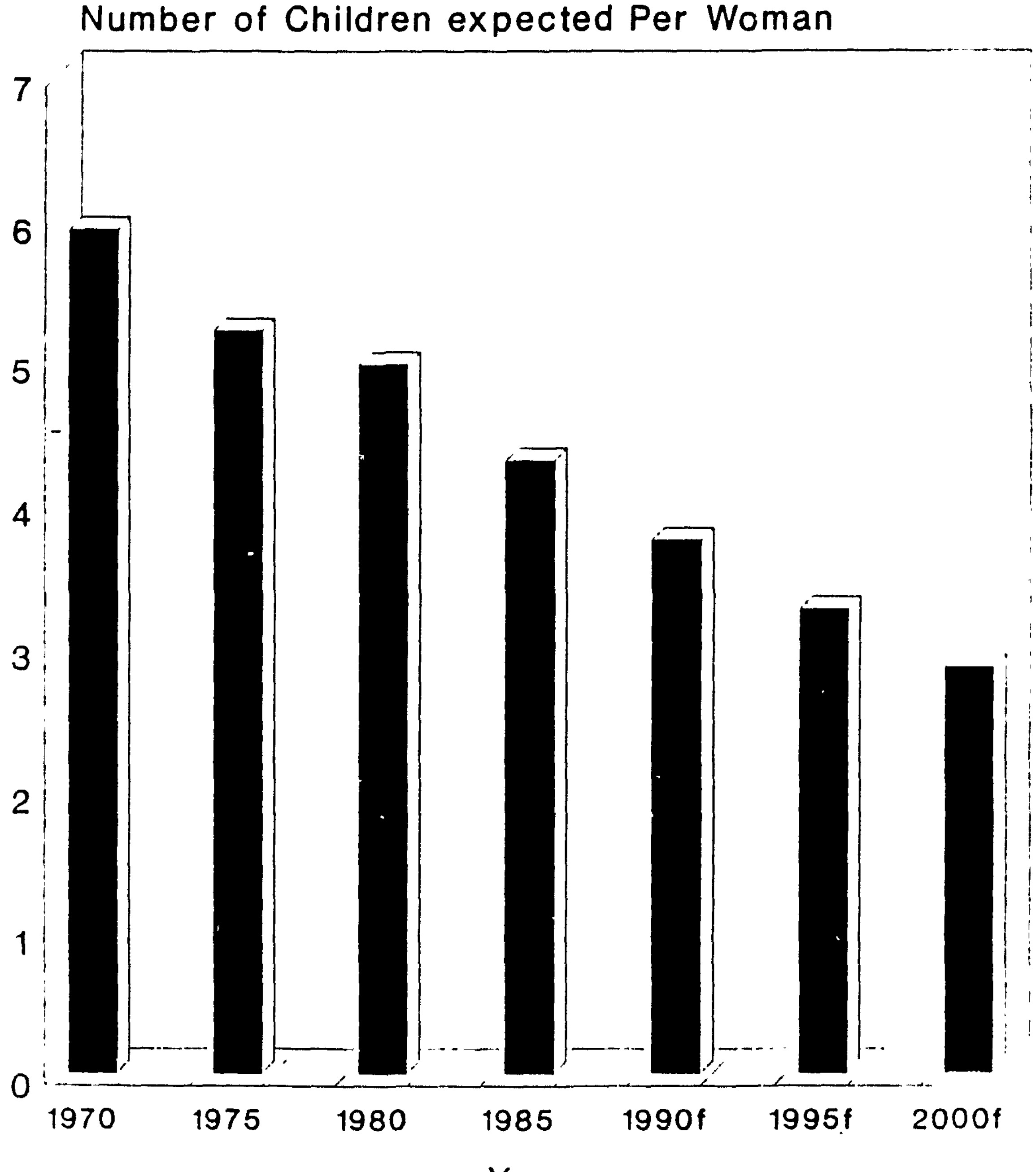
Implications from these trends for the 1990s in the Philippines are for only slow transition: high dependency ratio; childhood mortality, morbidity and malnutrition as high priorities in the government's health programs and services; growth in the country's labor force, currently estimated at 750,000 to 1 million new job applicants every year; allocation of public resources for primary/secondary education -- more will be needed if access to primary/secondary education is to improve; and, postponement of introduction of new skills in response to emerging manufacturing and service industries.

6. Urbanization

Urban population is expected to grow by 3.1 percent annually, from an estimated 26.4 million in 1990 to 37.2 million in 2000 (based on the projections from National Statistical Office. See graph on page). Non-urban population, on the other hand, is projected to grow by less, at 1.1 percent annually, from 35.5 million in 1990 to 40 million in 2000. As a ratio to the total, urban population is likely to increase to 48.2 percent in 2000. The urban-rural ratio is expected to increase to 93.1 percent in 2000.

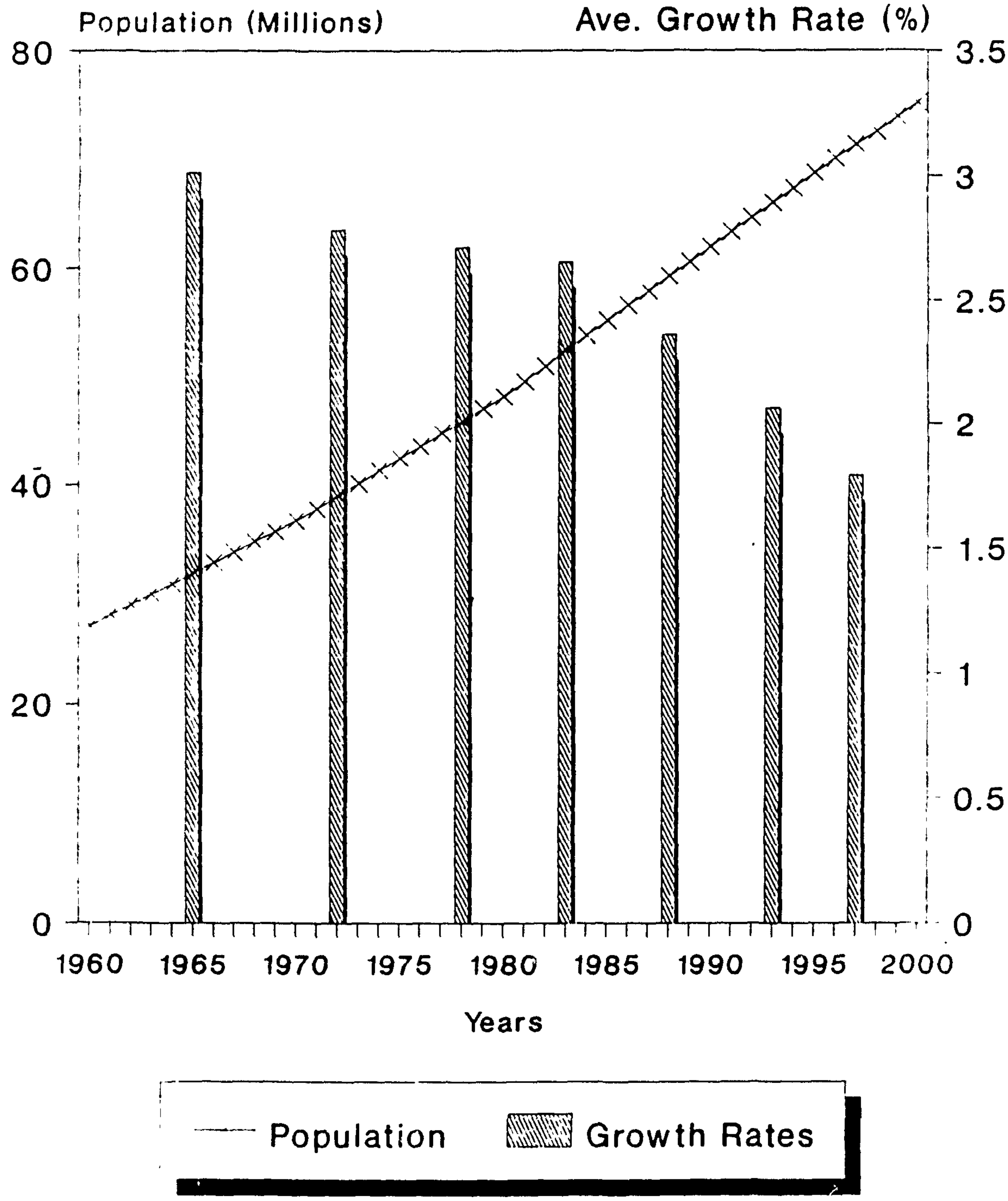
Around two-thirds of urbanization trends are expected to be outside the National Capital Region (NCR). Non-NCR urban population is expected to increase by 3.5 percent annually to 27.1 million in 2000, equivalent to 35.1 percent of total population. NCR population, on the other hand, is projected to grow by 2.1 percent annually to 10.1 million in 2000.

TOTAL FERTILITY RATE
Philippines: 1970-2000

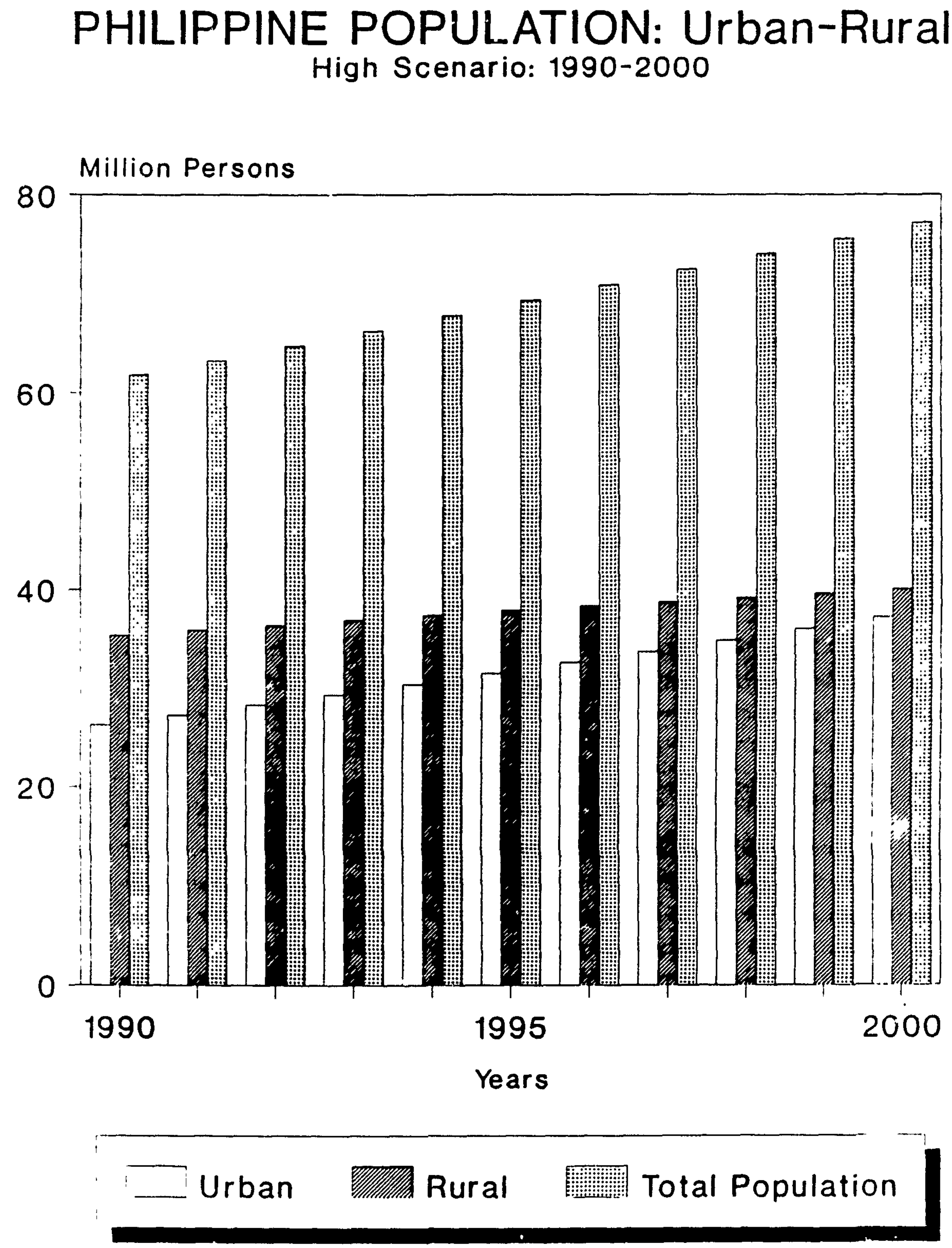


f-Forecasts based on moderate asspts.

PHILIPPINE POPULATION, 1960 TO 2000 (*)



* - Actual: 1960 to 1980



PHILIPPINE POPULATION: Urban-Rural
High Scenario: 1990-2000
Million Persons
80
60
40
20
0
1990
1995
2000
Years
Urban
Rural
Total Population

Metro Cebu, renowned for its tourism and home to major nontraditional export industries, is fast catching up to Metro Manila as the next major urban center in the country. Other emerging urban centers are Batangas City, Cavite and Laguna (CALABAR area), Iloilo City, Bacolod, General Santos City, Iligan City, Davao, Cagayan de Oro and Laoag City.

E. Constraints to Sustainable Economic Growth

Despite the progress that has been made in liberalizing the economy or opening markets and in achieving an open society in the first half of the Aquino administration, many constraints to sustainable growth remain. These can be discussed under six main headings: the direction of general development policy, institutions, private sector, infrastructure, essential services, and natural resources management. Success in removing these remaining constraints is essential for furthering the objectives of accelerating economic development and for realizing sustainable growth.

1. Policy Orientation

In several critical areas, incomplete adjustment of policy directions or the lack of sufficient implementation of announced policies still obstruct economic growth. In general the effect of current policies, despite substantial efforts and progress, is to allow the continuation of an inward-looking economy with resulting balance of payments crises, insufficient job creation and inequality of opportunity and choice.

An overvalued exchange rate interferes with the smooth functioning of markets. It causes Philippine exports to be less competitive in international markets, earning the country less foreign exchange and creating less jobs. It depresses domestic agricultural prices and lowers incomes derived from agricultural activities. It does not allow markets to operate efficiently.

The remaining level of relatively high nominal tariffs and some quantitative import restrictions contribute to the high and uneven level of effective protection. This maintains biases in favor of import-substituting, capital-intensive industries and biases against exports, labor intensive outputs and agricultural products. It contributes to the current transportation problem by discouraging investment in new buses and ships. Philippine goods produced by this industrial base have not been competitive on international markets, limiting sustainable economic growth a .d job generation.

Difficulties in the macro management further compound the problems of the orientation of the economy. Managing the economy well is extremely difficult with severe domestic and foreign debt burdens, low revenues, high popular expectations, damaged institutions and infrastructure, and active extra-constitutional oppositions--mostly inherited from the Marcos era. But improvements can and must be made. A major macro concern is the public sector's borrowing crowding out private sector investment.

While inflation rates remained at single-digit levels during 1986-88, the rate for 1989 (December to December) increased to 14.1 percent. Reflecting the higher inflation and prolonged overvaluation of the peso and the resulting monetary policy responses, interest rates also increased sharply in 1989. The consolidated public sector deficit for 1989 is estimated to be 4.4 percent of GNP, continuing the increases since 1987. The public savings and investment gap has followed a similar pattern, growing to 3.8 percent of GNP in 1989.

2. Institutions

The ability of political and economic institutions to function efficiently constitutes a necessary component for sustainable economic growth. During the Marcos regime, the functional ability of many institutions necessary for both open markets and an open society declined markedly, leading to the current situation of pervasive weakness.

Inadequate public accountability in government service and poor enforcement of laws and regulations both fundamentally constrain economic growth in terms of lost economic efficiency and erode the confidence of the citizenry. The problem may be traced to the unclear rules on ethics governing government service, poor enforcement of ethics laws and anti-graft laws and regulations, lack of discipline among government managers, inadequate salaries of government personnel, and excessive regulation with many discretionary decisions. Poor enforcement of laws and regulations include inadequate safeguards against monopolistic practices, poor implementation of anti-trust provisions of various laws, and slow judicial processes.

An open society requires channels by which citizens can effectively voice their views and influence the legal processes for change. The heavy centralization which characterizes the Philippine government prevents this from occurring efficiently. Decentralization can remedy this by bringing the decision-making process closer, physically and in terms of communication, to the citizens. The strong Philippine private sector, including both non-governmental and not-for-profit organizations, must be strong in voicing responsible views and desires.

The institutions which support the private sector and are necessary for open markets need strengthening. The financial sector suffered heavily during the economic crisis of the early and mid 1980s, and has yet to return to its pre-crisis size. It does not currently serve all segments of the country or all financial needs, hindering open markets and lessening efficiency.

Marketing institutions, particularly in agribusiness, have historically been extremely overcentralized and often government run. Successful deregulation and decentralization will foster more open markets. Although there are ongoing programs dealing with technology generation and transfer, especially as related to agriculture, they need to be more relevant and effective. In the critical areas of trade and investment, the government institutions hinder rather than promote efficiency; the myriad regulations and their unpredictable enforcement by the Board of Investment deter foreign investment.

3. Private Sector

The Philippine private sector, in both its indigenous and foreign elements, can be characterized as one of the most active and talented in the developing world. However, it is hampered by weaknesses in international competitiveness, access to financial resources to seize business opportunities, and training opportunities to address productivity concerns. These weaknesses are aggravated by remaining problems in the policy and institutional framework and inadequacies in infrastructure. While the Aquino administration is committed to the private sector being the engine for Philippine growth and has made substantial progress in addressing most of the constraints to the realization of this, much remains to be done.

The difficulties in macro management of the economy, such as excessive budget deficits, overvalued exchange rate, and high and uneven level of effective protection for import-substituting industries, interfere with the efficient functioning of markets, depresses domestic prices of agricultural output and creates uncompetitive world prices of Philippines exports. This discourages realization of private business opportunities and retards growth of the private sector.

The martial law period brought about a serious dominant involvement of government corporations in the economy to the extent that government is engaged in most businesses. In order to allow the private sector sufficient room to develop, the Aquino government has initiated and made progress on divestiture or privatization of numerous government owned or controlled corporations and acquired assets. However, the process is slowing and obstacles have arisen. The resistance of the bureaucracy, legal obstructions, and the maneuverings on behalf of vested private sector interests have proven formidable obstacles. Continued slow progress on privatization may result in continued subsidized public sector competition with the private sector, as in agribusiness, and creation of the impression among investors that the GOP is not seriously committed to reform.

An important aspect of the current private sector working environment is the inadequate presence of medium-sized private enterprises. This missing group and the difficulty of small-scale enterprises in graduating into the medium-size category originated with the long-standing policy and regulatory constraints which favored growth of large capital-intensive firms. This phenomenon has hindered the attainment of employment generation and sustainable growth. Serious biases against labor-intensive small-and medium-sized enterprises continue to exist such as the distorted investment incentives system, excessive regulation, over centralization of government.

The investment incentives system does not provide proper business signals to the private sector. Incentives discriminate against small and medium size enterprises, which are important for building a solid foundation for the economy. Furthermore, the bureaucratic regulatory structure of the Board of Investments (BOI) results in uncertain interpretation and implementation of investment policy, a high level of red tape, and inadequate promotional activities.

Present inadequacies in infrastructure, particularly in transportation, communications and energy, severely limit opportunities for private sector activities. Overall reliance on government to provide many basic services also has restricted private sector growth as well as caused inefficient delivery. Further strengthening of support institutions in the areas of finance, marketing, trade and investment promotion, and technology generation and transfer are urgent to support private sector initiatives and realize business opportunities.

The Aquino administration has made significant progress in deregulation, with beneficial results for the economy. However, this progress was confined largely to the agricultural and, to a lesser extent, power sectors. Excessive regulation continues to slow growth. In the transportation sector, pro-cartel regulatory restrictions on licensing and route allocations and controls on fares, rates and tariffs impede efficiency. In foreign investment, BOI's implementation of regulation constitutes a major obstacle to attracting more investment.

4. Infrastructure

Unanimously and continually, private sector representatives cite inadequate infrastructure as the key constraint to more rapid private sector growth in the Philippines. Rapid economic growth during the past three years has highlighted the need for more infrastructure. Multi-billion dollar investments in transport, power and telecommunications are required during the next five years in order to relieve this constraint to development.

The severe shortage of land transportation facilities makes travel in general and shipment of goods much more difficult and more costly than it need be. The International Food Policy Research Institute recently reported that the Philippines has the highest transportation costs in Southeast Asia. Poor maintenance of the existing infrastructure has resulted in the need for extensive rehabilitation. The lack of a national master plan for transportation infrastructure hinders more efficient planning for additions to the existing stock.

The insufficient number and quality of farm-to-market roads and irrigation services restricts improvements in the performance of the agricultural sector. Agricultural productivity is largely dependent on the existence of proper infrastructure facilities. A poorly maintained and inadequate road network serves as a major impediment to the flow of goods from the production areas to market centers and contributes to losses incurred in the agricultural sector, translating to millions of pesos daily. Delays in the distribution and marketing of goods also have great cost implications for the consumers.

Inadequate water and sewage systems and the inadequate and uneven distribution of hospitals and other health facilities have had negative effects on the health of the general population. Inadequacies in urban infrastructure related to shelter throughout cities and towns of the country have contributed to poor housing conditions.

The provision of electric power has not expanded in recent years. However, energy demand has grown between 1986 and 1989 by more than 8 percent per year and now severely taxes the system's capacity. Power failure in Metro Manila causes problems for the industrial as well as other sectors. Power shortages resulted in more than $1.2 billion in economic losses to manufacturing and service industries in 1989. The deterioration of the electric cooperatives under the Marcos administration affects many areas, obstructing plans for spreading growth. Private sector investment in power facilities has been hampered by bureaucratic delays in the issuance of rules governing private sector participation in power generation.

Domestic telecommunications service is also significantly below standards necessary for maximum economic growth. There is only one telephone for every 1,000 inhabitants, less in areas outside the National Capital Region. In a recent study by the Center for Research and Communications, the Philippines was identified as having the least developed communications in all of Southeast Asia. Their analysis showed that without increased investments in communications, the Philippines could not achieve its dream of becoming an industrialized country.

For both power and telecommunications, delays in implementing stated policies for private sector involvement as well as in providing financial incentives hinder quicker solutions through the private sector undertaking infrastructure construction and providing services. Examples of specific areas that could benefit include municipal-private sector provider-phone service and alternative land distance telephone carriers.

In the case of infrastructure, the areas outside the NCR have greater potential for progress toward the USAID goal than does the NCR itself. This results in large part from past government biases in favor of the NCR.

5. Essential Services

While there has been some decline in the fertility rate over the past two decades, the Philippines still faces a serious population growth problem. If the current growth rate is maintained, the present population of 62 million will increase to 75 million in the next 10 years. This rapid population growth severely constrains economic prosperity in the Philippines. It has created labor surpluses which depress real wages and impose unsustainable pressures on the country's natural resources. The Philippines has consequently exhausted its supply of unutilized productive land and destroyed much of its natural resource base.

The population growth problem springs from the wavering commitment of the government to implementing a family planning policy, due to the strong objections of the Catholic Church to artificial methods of birth control. Trying to change attitudes towards family planning and encouraging sustainable private sector involvement present major challenges. Private and government family planning services are seriously lacking, and are not even accessible to all those who already wish to use them.

The inadequate delivery of health services, poor nutrition, and unsanitary housing conditions cause the continued prevalence of preventable diseases such as tuberculosis and endemic diseases such as malaria. The health sector faces institutional, financial and manpower constraints.

The education system, which is critical for future economic growth and maintaining an open society, is also deteriorating. This is seen in the increasing illiteracy and decreasing skill level of Philippine youth, declining quality of schools, and increased inefficiency.

Both supply and demand factors shape the status of the delivery of essential services. On the supply side, it is important to further the role of the private sector and better target public sector programs to ensure an adequate supply of essential services for the entire population. The weakness of effective demand can be best addressed through sustainable growth with resultant job creation and more equitable distribution of opportunity.

6. Natural Resources

The absence of effective natural resources policies and management (exacerbated by an ever-increasing population, and deterioration of national living standards, particularly in the non-urban sector) has depleted the Philippines' once-rich natural resource base and degraded the environment. Timber overcutting due to the failures to curb illegal logging and impose realistic resource rents, compounded by the practice of slash and burn agriculture of upland migrants, has devastated the nation's forests. From 58 percent of actual total land area in the 1950s, forests declined to an estimated 3 percent in 1989. Presently, 700,000 hectares of old growth forests, currently valued at $7 billion, remain and at present cutting rates, these may be logged over within 7 years. Along with the depletion of the tropical hardwood forests, at least 50 percent of endemic forest flora of the Philippines having immense medicinal and technical use, is now gone. Once forests in the lowlands disappear, pressure on the remaining hardwood in the uplands increases. Productivity of the uplands as a result, are likely to diminish, spawning adverse effects as well on downstream agricultural activities.

Other sectors of the economy that thrive on the natural resources sector, particularly the wood-processing industries, are currently exposed to an unstable wood supply situation. Unless current depletion trends are arrested, the economy is bound to lose foreign exchange earnings from the wood and wood-processing industries amounting to $300-400 million annually, tax revenues of at least $300 million annually and 76 million person-days per year of employment in the countryside.

Some 70 percent of mangrove and coral reefs have suffered severe damage or complete destruction due to unsustainable fishing techniques. In 1988, only 140,000 hectares of mangroves were estimated to exist, a decline from 228,000 hectares in 1972 and 450,000 hectares in 1918. Widespread soil erosion and substantial losses of watersheds are severe consequences of natural resource mismanagement that could hasten the reduction of the amount of arable lands and cause flooding problems.

The government's heavily centralized management of natural resources that excluded the participation of the local communities and the private sector may have precluded the sustainable use of natural resources for development. Rather than opening markets, the inevitable result will be the irrevocable closing. Further, about 60 percent of Philippine population that resides in the rural areas and are dependent on natural resources, agriculture and fishing for their livelihood are likely to be driven further to poverty unless sustainable management techniques involving the private sector are adopted. The problems have now grown too large for any approach not involving a coordinated public/private sector partnership. The government has now begun to emphasize actions that address these problems, including the National Forestation Program and the Integrated Social Forestry Program.

III. USAID STRATEGY

A. Goals and Themes

The overall goal of the USAID program, as expressed in the ANE Bureau's cable summarizing the results of last year's Program Week, is **to promote broad-based, sustainable economic growth through the active partnership of the public and private sectors in fostering efficient private sector markets.** USAID is pursuing this basic goal within the comfortable and appropriate context of the Bureau's strategic goals of open markets and open societies. The successful achievement of sustainable growth depends on the openness of the economy and on the establishment and maintenance of democratic institutions and processes. An open society helps generate and sustain economic gains, and achievement of economic benefits in turn assists in preserving democracy.

Three themes cut across the USAID program: **policy reform, support for the private sector and decentralization.** Policy reforms are crucial because many major constraints to development are inappropriate policies, and specific activities have little chance for success if the policy environment works against them. USAID focuses on policy constraints, to one degree or another, in all its programs.

The private sector is and will be the primary engine of Philippine economic development. Under competitive conditions, it is the most productive source of growth and the most efficient provider of goods and services. Further, with substantial un- and underemployment, job creation by the private sector is essential for political stability and the preservation of an open society.

Decentralization means placing resources, responsibility and authority at the local level so that citizens have a greater voice in governmental decision-making and resource allocation. This is necessary for furthering the openness of the society and delivering effective infrastructure and basic services to support open markets. Local officials and entrepreneurs are better positioned to identify and respond to opportunities.

The program focuses primarily, but by no means exclusively, on areas outside the National Capital Region (NCR). Urban centers outside the NCR will be increasing in programmatic emphasis during the strategy period. Non-NCR urban areas, which together contain 70 percent of the urban population, particularly where private sector opportunities are plentiful, will be important beneficiaries of the USAID strategy. In addition, the Mission will aggressively pursue opportunities for carefully directed technical assistance on Manila urban issues, particularly where it does not require intensive management.

This focus on development outside the Metropolitan Manila region or the NCR is based on expected returns. Although high return opportunities may arise occasionally in the NCR, generally USAID efforts outside the NCR will provide greater returns in terms of per dollar impact on growth, open markets and an open society. Despite highly visible problems, returns for USAID activities in the NCR are limited because of past concentration of public investments, the large scale required for further capital investments, and the high interest of other major donors in massive Manila infrastructure.

Health and population activities and policy reforms, pursued through an increasing number of programs as opposed to projects, are clearly national in scope. The expanding work in the informal sector will even have a clear Manila bias.

B. Objectives and Performance Indicators

Within the context of the overall goal of sustainable growth, open markets and an open society, and cross-cutting themes of policy reform, private sector and decentralization, USAID's program itself focuses on the five programmatic objectives agreed to last year during the Bureau's Program Week.

Each is considered an essential component or element of the USAID strategy, and are as follows:

1. **A policy and institutional framework stimulating market-based private sector growth;**
2. **Open and competitive markets;**
3. **Infrastructure that facilitates expanded private sector activity;**
4. **More efficient delivery of essential services**; and,
5. **Effective and sustainable management of natural resources.**

For each objective USAID has identified preliminary performance indicators which are to be reached by the end of the five year period covered by this document. 1989 will be the base year for measuring increases and reductions. The indicators need to be confirmed, both internally and with the Bureau, through a necessarily iterative process. Over the next year USAID will be working to adjust and specify more thoroughly these indicators.

1. A Policy and Institutional Framework Stimulating Market-based Private Growth

Major problems of the Philippines stem from the inappropriateness of development policies, or the inadequate implementation of appropriate policies, i.e., overvalued exchange rate, protectionist trade regime, uneven macro management. Through ongoing dialogue, studies, and program conditionality, USAID promotes the use of market forces in determining the exchange rate as crucial for increasing exports, improving the balance of payments situation, and encouraging broad based, sustainable growth.

In discussions with the GOP and through research efforts, USAID also emphasizes sound macro management of monetary and fiscal policies to establish an environment conducive for open markets and to avoid crowding out of private investment. Liberalizing trade is also encouraged through performance cirteria for budget support, because USAID believes that this will increase the openness of markets and encourage a desirable pattern of growth.

As one key policy indicator of performance, USAID has set as a target a 50 percent reduction in the average effective rate of protection for the economy by the year 1995. This is expected to give back to Philippine export products their competitiveness and to influence a sector-neutral allocation of scarce resources between industry and agriculture. USAID will continue to include liberalization in program conditionality, provide studies to address specific problems, and assist private sector groups which push the advantages of an open trade regime.

Institutional bottlenecks and weaknesses are often constraints to open markets, an open society and sustainable growth. Examples are the lack of public accountability, poor enforcement of laws and regulations, excessive centralization, slow judicial processes for resolving conflicts, and weak institutions supporting private enterprise. USAID technical assistance efforts are aimed at addressing constraints that are impeding effective GOP program and project planning and implementation, improving the effectiveness of the judicial system, and enhancing the development of private enterprise support institutions. Critical institutions include those for finance, marketing, trade and investment promotion, and technology generation and transfer.

In addition, USAID's emphasis on decentralization through program assistance and housing guaranty supports the open society goal by moving decision-making authority closer to the people affected. USAID is also moving into supporting improvements in the judicial system, through a grant to the Asia Foundation, and, while keeping in mind the political sensitivities of Philippine-American relationship, will be looking aggressively for additional opportunities for advancing democratic pluralism by strengthening progressive trade associations and encouraging responsible journalism.

As one key institutional performance indicator, USAID is aiming for a 100 percent increase in real terms of discretionary resources for local government units (LGUs) by 1995. An important feature of local autonomy is the devolution, not only of authority, but most importantly, of discretionary financial resources to LGUs. Administrative capacity must also be built. Resources which are under the administrative discretion of LGUs are essential in the delivery of essential services by LGUs to their constituencies.

Another key institutional performance indicator is in the area of improved formal credit available outside the NCR. Insufficiency of credit from formal institutions is a critical bottleneck to private sector initiatives. USAID is tentatively targeting a 50 percent increase by 1995 in the real amount of formal credit provided outside NCR.

2. Open and Competitive Markets

USAID views the private sector as both a beneficiary of development efforts and an agent of change. USAID strives both to encourage private sector development and to utilize it in achieving developmental goals. To achieve sustainable growth, an open economy and an open society, the private sector plays the critical productive role; in turn, progress toward these ends means increased opportunity for the private sector. Opening markets is essential to enable the private sector to play a stronger role in the economy.

USAID is focusing significant financial resources and policy reform efforts to alleviate the constraints to an increased private sector contribution to Philippine development. While the Aquino administration has made substantial progress in undoing past excessive interventions into and controls over the private sector, much remains to be done. Through its policy dialogue efforts, studies, projects, and performance based program support under MAI, ESF, DA, PL 480 and housing guaranties, USAID is improving the policy environment for private sector activities. In particular, to create a climate more conducive to business, USAID is encouraging a more open economy with competitive exchange rate, neutral investment incentives, and reduced public involvement in and regulation of the economy.

Through dialogue and studies, USAID is urging a competitive exchange rate and a neutral investment incentives system -- in terms of sector, factor, size and location -- which will allow economic development to follow the Philippines' comparative advantage and will lead to more sustainable growth. Through both project and program assistance, USAID is pushing for reduced government involvement in the economy through the privatization of public corporations. Through program assistance, USAID is supporting deregulation or minimum regulation by the government, e.g. deregulating the transport sector and investment registration. USAID is also providing short term and long term technical assistance to analyze, identify solutions and generate appropriate policy guidance in several key areas, such as investment incentives, transportation policies, and financial markets.

Within several projects and programs, USAID is stressing an enlarged role for the private sector in the provision of essential services such as health and family planning and natural resource management. Under the MAI, USAID is breaking new ground for promoting, through feasibility study support and mixed credit financing, the use of the private sector, including U.S. companies, for major capital projects.

Through a number of projects, USAID is addressing the institutional constraints to conducting business in the Philippines through the encouragement of reforms and direct assistance activities. USAID is also providing direct assistance through several projects to the private sector to accelerate more private investments and trade and to encourage small enterprise credit. USAID finances training requirements of the private sector for technical and managerial training to address selected constraints to productivity and profitability of private enterprises. Substantial USAID resources are being directed at alleviating the infrastructural constraint to doing business through several projects. Priority is being directed to the provision and improvements in roads, ports, markets and telecommunications to open up the economy and facilitate private sector activity.

USAID is also supporting through projects the development of private sector business groups and Philippine and U.S. NGOs/PVOs to strengthen the voice of the private sector vis-a-vis the government, as well as to promote greater choice for the further development of the country's economic growth. Through co-financing, USAID supports community development work of private companies. USAID also provides technical assistance to private institutions which support private enterprise activities, i.e. chambers of commerce, private research organizations ar . trade associations.

USAID resources for the private sector will continue to increase during the Strategy Statement period. See Section IV.A for details on USAID approach to and activities benefitting the private sector.

As one key performance indicator, USAID aims for the 80 percent completion of the privatization of identified government-owned and controlled corporations and APT (Asset Privatization Trust) acquired assets by 1995. Privatization holds the key to minimizing the role of government in business. It signals the overall sincerity and determination of the Philippine government to allow the private sector to play its role as the primary engine of growth.

Another key performance indicator is the 50 percent reduction in the biases of investment incentives by 1995. This will reduce biases against labor-intensive, agricultural and small and medium businesses and encourage overall neutrality in the investment incentives system. Neutrality encourages efficiency in the use of the country's factors of production, leading to high value added contributions of industry and agriculture and high rate of absorption by industry of surplus labor from agriculture.

In the area of deregulation, USAID is aiming for substantial deregulation of interisland shipping with a performance target of 50 percent of all routes under MARINA protection deregulated by 1995. Deregulation in interisland shipping is crucial to opening markets, improving opportunities for the private sector and allowing more choice throughout the country.

3. <u>Infrastructure That Facilitates Expanded Private Sector Activity</u>

Adequate infrastructure to open up markets and the economy is crucial to expanded private sector activity and future growth, as private sector spokesmen invariably note. Linkages between the metropolis, secondary cities, market towns and production areas are essential to stimulate economic growth, create jobs, spread the benefits of growth and the Philippine's relatively open society. While changing policies is critical, as the USAID recognizes by putting a heavy emphasis on policy dialogue and conditionality, adequate infrastructure, including secondary and tertiary roads, air and waterway linkages and telecommunications, is also necessary to facilitate the development of open markets. The availability and reliability of power, including that provided through the rural electric cooperative system, is a prerequisite for utilizing the country's current production potential, for attracting additional private investment, and for expanding market opportunities.

In this area, USAID directs financing, hopefully including mixed credits to assist U.S bidders, towards capital projects and infrastructure supporting the development of agri-business and the opening up of potential areas of economic growth. USAID will allocate substantial portions of the ESF and MAI to infrastructure programs during the Strategy Statement period.

By 1995, USAID targets, as a key performance indicator, providing at least seven million Filipinos more access to economic opportunities through new and improved roads, ports, air navigational equipment of airports, and market facilities. Access to markets, employment and business opportunities has a multiplier effect in terms of increased investment and consumption.

Another key performance indicator is improved power service to at least two million households and business enterprises nationwide through the rehabilitation of electric cooperatives by 1995. Relieving the current power constraint is critical for allowing uninterrupted growth. Available and reliable power supply will induce increased investment and entrepreneurship as it makes more predictable and lower business operating costs.

4. <u>More Efficient Delivery of Essential Services</u>

Efficiently providing adequate access to essential services, including family planning, basic health, nutrition, potable water, housing, sanitation and education, is basic to promoting economic development and political stability. For example, in the absence of a dramatic reduction in fertility, it will be increasingly difficult to provide adequate access to essential services, or to realize fully the benefits of growth. The development of human capacity bears directly on the citizenry's ability to contribute to and benefit from economic progress.

Efficient access is also the core of the results of open markets and open societies. People with access to essential services are more able to exercise meaningful choice for their own betterment as well as the overall development of society. Opening up the provision of essential services to private enterprise is the critical way of improving the efficiency and availability of these services.

Because there are not enough resources to improve service delivery across the board, USAID will work to strengthen the efficient delivery, improved targeting, and sustainable financing of the most critical services. Through project assistance, a significant effort is being made to strengthen the government and private sector ability to ensure efficient and widespread availability of family planning information and services. In health, through program assistance, USAID is focusing on improving the efficiency of resource allocation and delivery of services by both the private and public sectors. To improve housing, through housing guaranties, USAID is working through policy changes to enhance decentralized provision of shelter related infrastructure.

USAID's infrastructure program also bears on this sector. USAID is building health centers, schools, hospitals and water systems.

USAID expects to maintain only a low level of resources in this area over the Strategy Statement period as the private sector, responding to increased opportunities, provides a larger share of services.

One key performance indicator is the 80 percent implementation of a sustainable health financing strategy characterized by cost containment, cost recovery, increased private sector delivery of curative services and support for delivery of preventive services. Another indicator is the attainment by 1995 of 80 percent of impact indicators for child survival, e.g. 90 percent of children under age one are fully immunized and 80 percent of pregnant women receive tetanus toxoid vaccine. In the area of family planning, USAID aims to increase the contraceptive prevalence rate by 40 percent and to reduce the total fertility rate by 15 percent by 1995. This package aims to control rapid population growth and produce healthy productive members of society.

5. <u>Effective and Sustainable Management of Natural Resources</u>

Adopting sound natural resource management is critical to achieving the goals of open markets and open societies. A properly managed natural resource base ensures adequate supply of raw materials and production resources like soil and water which are essential for functioning of markets and for offering of the economic choice to the citizenry. In return, more open markets and an open society are necessary to preserve the natural resource base of the country.

To help achieve effective and sustainable natural resource management, USAID will pursue policies/programs to: (a) increase economic efficiency in the forest products and wood processing industries, and (b) promote economically and ecologically sustainable management of the Philippines's natural resource base with special attention to tropical hardwood forests and biodiversity. USAID will work towards bringing about a proper policy environment which will create initiatives and incentives for better forestry resource management. With the proper policy environment, effectively functioning market mechanisms willl emerge to encourage making and implementing economically sound decisions.

Through its policy dialogue, USAID will pursue GOP adoption of sustainable forest management systems, elimination of mechanized logging from remaining old growth forests in upper watersheds, and policy inducements for an efficient wood products industry. USAID will support building natural resource management policy capacity of both the government and the private sector. In this regard, USAID will fund a study to modify the national income accounts for forestry depletion to quantify the negative impact of past sector policies. Subsequently, this may be expanded to incorporate other natural resource categories.

USAID will also provide increased financial support to qualified natural resource management organizations such as Philippine and U.S. NGOs/PVOs through debt-for-nature swap arrangements and adoption of natural resource conservation programs. USAID expects to increase the level of resources over the Strategy Statement period in this area.

As key performance indicators, USAID aims for the adoption and actual implementation of sustainable forest management systems affecting 3.4 million hectares of secondary forests by 1995 and selective non-mechanized cutting on at least 400,000 hectares of old growth forests. Implementation of these targets is crucial in achieving effective and sustainable management of natural resources.

C. Policy Dialogue Agenda

The theme of policy reform cuts across all of the five USAID programmatic objectives or strategic thrusts. The following Policy Dialogue Agenda sums up the policy goals needed to support the achievement of each objective. USAID is engaged across this entire policy regime, and fully expects to have meaningful impact in each specific area noted, using all its vehicles, from DA to PL 480, ESF, HGs, and the MAI, in all their forms, from budget support performance criteria to project institution building and program assistance.

POLICY DIALOGUE AGENDA

GOAL: Sustainable, broad based economic growth
KEY: Furtherance of open markets and open society

CRITICAL COMPONENTS:

A Policy and Institutional Framework Stimulating Market-Based Private Sector Growth

- Market-determined foreign exchange rate
- Internationally open trade regime
- Stable macroeconomic conditions without crowding out of private investment
- Efficient and effective private enterprise support institutions, including financial, marketing, technology generating and transferring, and trade and investment promotion
- Greater autonomy and increased revenues for local government units (LGUs)
- Streamlined and effective program and project planning and implementation process
- Streamlined public sector systems and regulations and overall commitment to discourage graft, deliver justice and enforce anti-trust measures

Open and Competitive Markets

- Minimum public involvement in the economy
- Minimum regulation, including free input and output pricing for agricultural and export products
- Sector, factor, size and location neutral investment incentives regime

Infrastructure That Facilitates Expanded Private Sector Activity

- Adequate cost effective transportation through policy adjustments including deregulation to permit private sector competition and free entry
- Increased investments in and improved maintenance of roads, ports, vehicles and ships

More Efficient Delivery of Essential Services

- Effective private sector and government preventive health and family planning services
- Sustainability of health services through efficient resource allocation
- Informed effective demand for basic services

Effective and Sustainable Management of Natural Resources

- Privatization of user rights
- Enforcement of existing legislation for sustainable natural resource management
- Regulatory framework emphasizing user responsibility for public good replenishment and collection of economic rents

D. Program Directions

USAID is both adjusting its existing portfolio and directing future resources to support its strategy with the goals of sustainable growth, open markets and an open society. USAID is examining ongoing programs and projects for consistency with and contribution to that strategy. As necessary, USAID will be redesigning, reducing or eliminating activities that do not directly support the strategy.

For the future, USAID will be directing resources to support the strategy. The following Financial Resources Table shows planned resource allocation during the Strategy Statement period against the five objectives. The trends will be:

- Resources allocated to the policy reform objective peak during the early years with a downward trend, particularly in budget support, in the out years. Sectoral programs, TA, and directed studies to support policy dialogue will continue.
- The private sector objective shows a sharp increase of resources early on and maintains a significant upward trend in the out years. All the objectives are directed overwhelmingly at improving the environment for the private sector. Therefore, counted under this objective are only specific projects or programs or components of such where the private sector is the direct beneficiary or the final provider of the services or products.
- Infrastructure, including creating opportunity for U.S. business, will receive a significant level of resources with a steady increase through the period.
- With the emphasis of private sector participation in the provision of essential services, the direct resources planned in the area will be maintained essentially constant during the Strategy Statement period.
- Natural resources will receive a significant level of resources, somewhat increasing through the Strategy Statement period.

Financial Resources Allocation
by Program Objective
FY 1990-1994
($ million)

Program Objective	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994
POLICY:	110	177	164	144	120
A policy and institutional framework stimulating market based private sector growth					
PRIVATE SECTOR:	62	76	80	85	90
Open and competitive markets					
INFRASTRUCTURE:	102	126	135	146	160
Infrastructure that facilitates expanded private sector activity					
ESSENTIAL SERVICES	27	11	10	10	10
More efficient delivery of essential services					
NATURAL RESOURCES:	25	25	26	30	35
Effective and sustinable management of natural resources					
TOTALS	326	415	415	415	415

Note: In addition to the ESF, MAI and DA resources contained above, HG and PL 480 Food Commodities are expected to be $25 million and $41 million a year respectively over this period. HG and PL 480 resources, except for Title II targetted feeding programs, will also be directed at policy reforms.

IV. SELECTED SECTORAL SUMMARIES

A. Private Sector

1. Private Sector Strategy*

The centerpiece of USAID development strategy for the Philippines is the private sector, both indigenous and U.S. The private sector is viewed both as the beneficiary of development efforts and as an agent of change -- both a means and an end. To obtain sustainable growth, an open economy and an open society, the private sector plays the critical productive role; in turn, progress toward these ends results in increased opportunity for the private sector. The key to economic development is keeping the engine of growth -- the private sector -- on track and functioning ever better over time. This calls not only for continuous oiling and strengthening of the engine but also creating and maintaining an environment conducive to its smooth and efficient functioning.

An effective partnership of private and public sectors is a prerequisite for maximizing economic development performance. The important thing for government is not to do things which private individuals are doing already and to do them a little better or a little worse, but to do those things that cannot be done at all by the private sector. This includes providing a secure, stable and conducive policy and infrastructural framework within which the private sector can prosper.

The private sector must be the engine for propelling economic development, making investments, creating productive employment and producing goods and services. USAID/Manila's objective is to assist the GOP in creating an environment which encourages this to happen and stimulating the private sector to move into this role.

The Philippine Situation

The private sector in the Philippines, in both its indigenous and foreign elements, is one of most active and talented in the developing world. Its diversity and potential rival that of many advanced developing countries. However, the country is weak in international competitiveness, access to financial resources to seize business opportunities, and training opportunities to address productivity concerns. It is also hampered by remaining problems in the policy and institutional framework and inadequacies in infrastructure. While the Aquino administration has made substantial progress in undoing the excessive interventions and controls of the past, much remains to be done.

During the years 1972 to early 1986, the Marcos administration greatly expanded government control over economic activities, from provision of basic social services to agricultural monopolies and big industrial/manufacturing projects.

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* AYC Consultants: Private Sector Development Strategy, March, 1990

This produced economic misery for the country due to the inefficient use of scarce resources, depletion of renewable resources and the creation and capture of economic rents for the pockets of a privileged few. It also seriously constrained private sector activities.

The Aquino government has embraced the objectives of re-establishing the private sector as the mainstay for Philippine growth. However, there are still many constraints to the full realization of this ideal. Policies hampering the private sector include: distorted investment incentives, excessive regulation, over-centralization of government, unnecessary involvement of public corporations in the economy, international trade restrictions, a less than fully market-determined exchange rate, and a combination of fiscal and monetary policies which tend to crowd out private investment.

A review of the privately-owned, for-profit firms shows a wide disparity in the development of large firms and small enterprises -- with a missing middle category which should be occupied by medium-sized private enterprises. The large firms consists of only two percent of the total number of registered industrial firms but account for more than half of total employment. The very large number of micro/small enterprises remain inaccessible to public extension and support services. The combined phenomena of the missing middle category and the slow growth and inability of small scale enterprises to graduate into the medium size category can be traced to the long standing policy and regulatory constraints which favored growth of large capital-intensive firms while creating a serious biases against labor-intensive SMEs, which tend to be agriculture-based and outside the National Capital Region (NCR).

Improvements in infrastructure, particularly in transportation, communications and power, are needed to open opportunities for and support the activities of the private sector. The private sector invariably cites the lack of adequate infrastructure as the single greatest impediment to accelerating private sector growth. Support institutions needing further strengthening are financial, marketing, trade and investment promotion, and technology generation and transfer. Over-reliance on government to provide many basic services also limits opportunities for the private sector, results in inefficient delivery, and increases budget deficits.

USAID Role

USAID strategy for the private sector involves efforts both to encourage its development and to use it in achieving developmental goals. In addition to the extensive policy agenda, we are progressively developing projects for the private sector, building private sector objectives into broader projects, and incorporating the private sector into implementation. To the fullest extent possible, USAID is also striving to use the private sector, Philippine and U.S., as the means to deliver USAID assistance effectively and to improve the efficiency of the Philippine government delivery of basic services and infrastructure.

USAID is doing this by focusing significant financial resources and policy reform efforts on alleviating the constraints to an increased private sector contribution to Philippine development. Through its policy dialogue efforts and through the performance criteria related to its budget and sectoral program support, USAID is using all its assistance vehicles -- MAI, ESF, DA, PL 480, and HGs -- to improve the policy climate for private sector activity. In particular, USAID is encouraging a more open economy with market-determined exchange rate, neutral investment incentives, and reduced public involvement and regulation.

To these ends USAID is also providing short- and long-term technical assistance to analyze, identify solutions and generate appropriate policy guidance and institutional reforms in several key areas. The Harvard Institute of International Development Study on Small and Medium Scale Industries is but one recent example.

Existing technical and program assistance includes the objective of improving public accountability, enforcement of laws and regulations, decentralization, the judicial process, and institutions supporting the private sector in the area of finance, marketing, trade and investment, and technology generation and transfer.

USAID is also providing direct assistance to the private sector to accelerate more private investments and trade and to encourage small enterprise credit. USAID will be assisting Filipino businessmen to gain access to new markets and enlarging market share within established markets through a parallel project to the ANE ASEAN Representative Offices' Private Investment and Trade Opportunities (PITO) Project. By providing institutional support for private sector trade organizations, PITO-Philippines also establishes trade linkages with the USA and an intra-ASEAN private sector trade network. Our small enterprise credit project and our support for PRE's many guarantee programs in the Philippines seek to overcome financial constraints to diversification of business activity and build the institutional support framework.

Through its privatization project and Support for Development Program, USAID is pushing for reduced government involvement in the economy through privatization of public corporations. USAID is also supporting deregulation or minimum regulation by the government, such as deregulating the transport sector and investment registration.

In order to develop stable and competitive securities and banking regulatory systems supporting private sector activities, USAID's Financial Markets Mobilization Project will pursue policy dialogue with the GOP on attracting foreign investment and mobilizing local financial flows through capital markets reform. This is expected to redirect capital resources from public to private sector use in a sound and transparent capital market and will fuel a more rapid re-channeling of resources into a private sector-led economy.

Substantial USAID resources are also being devoted to alleviating infrastructural constraints to doing business. Priority is being directed to improvements in the maintenance of roads, ports, markets, and telecommunications to open up the economy. Special attention is being given to infrastructure supporting the development of agri-business and opening up of potential areas of economic opportunity for increased investments and employment.

Recognizant of the potential for expanding private sector investments through the upgrading of the human capital base of a private enterprise, USAID finances training for in-country, third-country and U.S. technical and managerial training for the private sector to address selected constraints to productivity and profitability of non-farm private enterprises.

By co-financing private sector efforts, USAID supports community development work of Philippine and U.S. NGOs/PVOs and private firms which promote greater voice and choice for the private sector in economic development activities. USAID also provides technical assistance to private institutions which support private enterprise activities, i.e, chambers of commerce, private research organizations and trade associations.

Assisting Filipino small entrepreneurs by expanding their ability to articulate their needs is the crux of USAID's informal sector assistance activities. The Philippines is a pilot country for PRE's Institutional Reform in the Informal Sector (IRIS) project. Through a buy-in, USAID will support research efforts aimed at reform of government regulations and policies, studies to encourage elimination of excessive regulations which encourage private businessmen to stay outside the formal legal system, and overall support to advocacy actions for long-term influence on policy reforms. USAID will be exploring a larger follow-on project in this area.

2. Financial Markets Development Strategy*

The economic crisis that affected the Philippine economy in the early and mid-1980s was particularly hard on the financial sector. The failure of numerous financial institutions, among them several large private commercial and thrift banks, two large government-owned banks and much of the rural banking system, was due in part to inadequate regulation and supervision, together with policies of low-interest credit for priority sectors that had created risky loan portfolios and excessive dependence on the Central Bank as a source of funds.

Since the crisis, there have been major reforms in overall financial sector policies, attributable in part to efforts of the IMF and the World Bank. USAID has played a major role through policy dialogue in improving financial policies for the non-metropolitan sector, such as the elimination or consolidation of numerous subsidized and directed credit lines.

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* IMCC: Philippine Financial Markets Development Strategy, December 1989.

Nonetheless, in terms of real deposit mobilization and real lending, the financial sector in general remains much smaller than it was at the end of the 1970s. In many areas, formal financial institutions are fewer in number and smaller in terms of real assets than they were in 1981.

The USAID strategy with respect to the financial sector, and especially concerning rural finance is to consolidate and extend the past successes in policy dialogue and reform, and to provide training and technical assistance that can speed the development of efficient and viable financial markets and institutions.

Policy dialogue and program interventions will be directed at specific areas where momentum is lagging (liberalization of exchange rates, macro-policies which tend to crowd out the private sector, and legislative and regulatory reform necessary to remove distortions, reduce financial market imperfections and encourage competition). USAID efforts to broaden the base of support for liberalization will include private sector associations, universities, "think tank"/research-oriented institutions and legislators, to broaden the base of support for liberalization.

Enhanced savings mobilization will be a specific focus within USAID's overall financial sector strategy. Successful savings mobilization increases the viability of financial institutions by providing greater independence (e.g., from subsidized Central Bank credit lines), while increasing funds for lending. To enhance savings mobilization, donor interventions will be required in a number of areas, including:

-- policy dialogue and research to demonstrate the importance of deposit mobilization and the need to remove policy barriers;

-- training to improve deposit mobilization techniques and overall liability management;

-- dissemination of computer hardware and software to rural banks to improve their efficiency in deposit management as well as overall accounting and financial management;

-- assistance to the Philippine Deposit and Insurance Corporation (PDIC) for training and recapitalization in order to increase depositor confidence and protect depositor interests.

B. Infrastructure

1. Transport Policies and Transportation Linkage Studies*

An efficient transport system and good infrastructure support are essential for opening markets and increasing economic opportunities for the private sector. Adequate cost-effective transportation is critical for open markets and for mobilizing economic development in the Philippines.

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* Discussion here is based on Robert Nathan & Associates' Transport Sector Review (Preliminary Assessment), March 1990, and a number of other studies, including the World Bank Philippines Transport Sector Review (March 1989), ADB Country Paper on Transport Policy (February 1989), and on the Final Report of the Government of the Philippines Presidential Task Force on Interisland Shipping (February 1989).

The Philippine transport system is generally characterized by inadequate maintenance of existing infrastructure and too heavy regulatory restrictions which encourage overall economic inefficiency, and reduce access to markets and business opportunities by the private sector. There is need, therefore, for policy adjustments, including deregulation to permit private sector competition and free entry, as well as increased investments in and improved maintenance of roads, ports, vehicles and ships.

The Philippine transport system is basically bimodal. Road transport handles about 65 percent of freight movement and 90 percent of passenger movement, while maritime interisland transport handles about 35 percent of freight and 7 percent of passengers. Air transport is limited and almost entirely handles passengers. Rail transport is negligible. Road and sea transport complement rather than compete with each other.

Outstanding Problems and Issues

1. Road Transport

Insufficient investment and inadequate maintenance of infrastructure are the principle obstacles to a growing economy. However, there are also a number of policy constraints which need to be addressed. Present regulatory restrictions not only pose an enforcement problem but are also economically unsound. The market segments most affected by these restrictions are public passenger transport, petroleum distribution and interisland trucking using ferries.

Franchising practices of the Land Transportation Office have resulted in cartels, e.g., the route 'rationalization' in East Mindanao. Government control on fares, rates and tariffs, in addition to the regulations on routes, restrict pricing flexibility and market entry, thereby reducing competition. Restrictions on imports of vehicles and spare parts and tires, as well as high import duties and taxes, contribute to the inadequate supply of public vehicles and high cost of maintenance and repair.

A significant test of the GOP's reform agenda will be: (1) a more comprehensive deregulation of land transport rules covering licensing and route allocations, control on fares, import controls on vehicles and parts, among others and (2) increased attention to road maintenance.

2. Interisland Shipping

Major problems besetting the industry are the high operating cost of interisland shipping and the resultant high prices charged to the industry's clients. Factors causing these conditions are: (a) inflated costs arising from the administrative management of the Philippine Ports Authority; (b) substantial tax burden on the industry; (c) pricing policies of the liner cartel, which are indirectly supported by the government's regulatory policies limiting competition. The industry faces also the problems of adequacy and availability of vessels for the movement of cargo and passengers as well as serious safety considerations. These problems are highly influenced by the inefficiency of the government's regulatory functions and of the operations of seaports.

Policy reform efforts started in 1989, especially fare deregulation for first and second class passengers, and partial deregulation of routes. Despite the significant deregulation measures adopted by the GOP, the following reforms need to be carried out: (a) deregulation of fares for third class passengers; (b) complete rationalization of the entire freight and passage rate structure; (c) complete deregulation of entry into specific routes by abolition of MARINA's five-year protection for shipping routes; (d) acceleration of privatization of ports, particularly the Port of Manila; (e) complete rationalization of port charges; and (f) liberalization of all imported spare parts and components.

3. Air Transport

Despite the dismantling of the government's one-airline policy, regulations still exist covering routes, competition from foreign airlines, and authorized charter operators which restrict market entry and pricing flexibility, leading to reduced competition and high cost of air fares. Other problems include poor supply of air navigational equipment, lack of adequate local maintenance capability and high cost of spare parts. Further reforms are necessary to: (a) completely deregulate routes and entry of charter operators and foreign airlines, (b) accelerate the privatization of Philippine Airlines; and (c) increased investments in air navigational equipment.

4. Rail Transport

A major issue is the financial viability of the Philippine National Railways (PNR), in light of the low volumes of traffic. An issue which needs to be examined is the probability of traffic volume increases if there are improvements in the service of PNR. The main issue with regard to the Manila light rail system is cost recovery and ability to service its debt, given restrictions on its ability to raise fares. In order to improve the cost recovery of LRTA, reforms allowing increases in fares need to be carried out.

USAID Role

Over the medium term, USAID/Philippines will be pursuing policy reforms to close critical gaps in the reform process currently being undertaken in the transport sector. These policy changes will complement USAID capital and technical assistance to achieve the increased efficiency and effectiveness in transport needed to support the Mission goal of sustainable growth through open markets and an open society.

USAID/Philippines is providing technical assistance to the Secretary of the Department of Transportation and Communication (DOTC) on air transport issues and to the Department of Public Works and Highways, through a transportation linkage study, to develop a methodology for a Public Works Investment Selection Plan (PWISP). The methodology will provide a means for prioritizing investments in infrastructure with special emphasis on transportation investments (roads, bridges, airports and ports).

The methodology uses a number of variables to categorize geographic regions based on their current economic status and their potential for economic growth. The analysis will be used by DPWH to determine indicative levels and types of infrastructure investment for different geographic regions. It will also be used by USAID to ensure that infrastructure investments under projects such as the Rural Infrastructure Fund will be allocated to areas which offer the most potential for economic growth, and where infrastructure appears to represent a critical constraint to private sector productive investment and growth. The analysis will be completed in April, 1990.

The Mission is also currently supporting research to examine the policy reform efforts of the Philippine government on the transport sector and will soon be funding an intershipping rate rationalization and deregulation study. Results of this research are expected to provide policy guidance to the GOP and USAID on economically desirable policy changes.

As a pilot country for PRE's Institutional Reform in the Informal Sector (IRIS) project, the Mission is utilizing an IRIS "buy-in" to deregulate the current 'jeepney' franchising system, in order to open up the market for operators and to provide a larger and more efficient system for their passengers.

Through the ongoing Rural Infrastructure Fund Project and other planned projects, USAID will directly support the construction of major arterial highways, ports, airport up-grading (including installation of U.S.-sourced air navigational aids), as well as other selected infrastructure which is critical to opening specific markets, e.g. a fishport in General Santos City.

2. <u>Energy and Power</u>

The Philippines is facing an energy crisis in its drive to accelerate economic development. The principle concern is the adequacy of power to support economic growth, particularly the industrial sector goals. The decision not to operate the 620 MW Bataan Nuclear Power Plant, the rapid economic recovery since 1986, the limited additional installed power generating capacity in 1987 and 1988, and deterioration of existing plants, have put tremendous strains on power generating capacity to meet demand. In late 1989, power generating capacity in the Luzon Province alone was less than 60% of installed capacity due to breakdowns of equipment and added damage by typhoons Saling and Tasing. Power interruptions and load-shedding in 1989 caused industrial losses of close of @27 billion ($1.25 billion), according to a study by Business World Research. At the same time, there is a continued shortage of power generating capacity of about 500 MW to meet demand. If GNP is to grow at the projected annual rate of 6.5 per cent, massive capital investment in the range of $1 billion per year in new power plants, rehabilitation of existing plants, and related infrastructure will be required.

The GOP has undertaken measures to improve energy efficiency and self-reliance, including policy reforms, energy conservation, fuel diversification, development of indigenous energy resources, and implementing changes in the energy pricing structure to reflect long-term marginal costs. In terms of capital investment, the GOP's $6.4 billion 1988-1992 energy program allots almost 60% of total energy sector investments to power development. The private sector is expected to shoulder 24% of the total energy investments to meet plans, via the implementation of Executive Order No. 215 which allows private sector ownership and operation of power plants and cogeneration units.

Plans by the National Power Corporation (NPC) call for a minimum increase of existing installed capacity by almost two-thirds by 1997 (from 5,792 MW to 9,594 MW). However, even with this minimum increase in generating capacity, peak demand is expected to double during the same period, and the reserve margin will decrease from 57% to 31%. Thus, the power sector is expected to be a critical constraint to Philippines efforts to achieve sustainable development. Substantial private sector capital investment and donor support will be required for the Philippines to meet minimum power sector goals.

In conjunction with a power supply program the GOP attaches substantial importance to energy conservation and management of energy consumption through pricing policies, regulations reducing energy consumption and enhancing efficiency, promotion, training and dissemination of energy conserving measures and technologies, and support for renewable energy use and expansion. Under the Office of Energy Affair's (OEA) industry energy efficiency program, the efficiency of industries consuming more energy than one million liters of fuel oil equivalent are being monitored regularly, and the larger industries of the country are being required to implement energy conservation programs and efficiency targets. Other energy conservation measures and pilot projects being undertaken by OEA with support from USAID, the Federal Republic of Germany, the World Bank, the Australians, UNDP/UNIDO and others, in cooperation with the commercial and industrial sectors, have shown a substantial potential for improving energy use efficiency. The GOP plans to continue and expand such efforts.

The major donors for power development in the Philippines are the Asian Development Bank (ADB), the World Bank and the Eximbank of Japan. The ADB Fifteenth Power Sector Project (1990-1993) will provide a $160 million loan to NPC for geothermal development, inter-island electrical connections, operations and maintenance improvement, and 15 small island 150 KW to 500 KW diesel power supply stations. During the period 1990-1994, the World Bank and the Eximbank of Japan will provide $390 million and $250 million, respectively, under an Energy Sector Loan Program. This program wil finance power plant construction and rehabilitation ($350 million) geothermal development ($150 million), oil and coal import support costs ($100 million), and program and budgeting support costs for various Philippine agencies involved in the energy sector ($40 million).

The GOP is also receiving a number of expressions of interest from the private sector for private power development (fossil fuel, geothermal and hydro) as a result of Executive Order 215 Identified projects currently include a $45.5 million private sector build-operate-transfer (BOT) 200 MW gas turbine private sector power project in which the ADB is providing $11.1 million in debt and equity financing, and a 300 MW coal power BOT project in which private sector proposals will be received by NPC on February 27, 1990.

USAID Role

USAID has been providing limited technical assistance and training in energy planning and private power development and is supporting energy conservation and the rural electrification subsector through two ongoing projects totalling $45.6 million. One project, the Rural Electrification Project ($40 million), provides assistance to improve the management, energy efficiency and financial viability of the rural cooperative electrical distribution system of the Philippines. Technical and non-technical losses averaging 20-25% are proposed to be reduced to 15% or below with technical assistance training and commodities for improved operations. The other project, an energy conservation project ($4.6 million - Technology Transfer for Energy Management), provides assistance to the public and private sector in training, and promotion of energy efficiency through pilot investment loans for private sector application of energy efficient technologies.

The Mission's ongoing energy programs support A.I.D.'s objectives of opening markets for the private sector through privatization, increased local and foreign trade and investment and development of basic and critical infrastructure in support of the GOP's development plans. Over the planning period, the Mission proposed to expand its support to the Philippines for the energy power sector to respond to the critical need of the GOP to meet its economic development goals. This support will include technical assistance for energy sector planning, resource assessments, feasibility studies, and analyses and designs of power projects. Energy sector planning assistance will be oriented to power system planning, investment planning, development of a functional private power development framework, establishment of environmental guidelines for power development, and institutional development and training.

Capital assistance will also be provided to expand the Mission's ongoing program in support of private sector energy conservation and cogeneration development, and to meet some of the foreign exchange costs of the massive GOP power sector investment requirements. Capital financing for power projects would include commodities or other capital costs for MPC projects and/or possible support for private sector power BOT and turnkey project proposals. Finally, energy would be a key sector for inclusion in the mixed credit facility under development by Washington and USAID.

The proposed increased technical and financial support for th energy/power sector is consistent with Congressional Directives and A.I.D. policy stressing the importance of energy as an essential ingredient for growth, increased agricultural output, industrial productivity and social well-being of the populace. The proposed support will focus on improved energy efficiency, national energy planning, investment in end-use efficiency, national energy planning, investment in end-use efficiency, and support for development of indigenous and renewable energy resources such as hydro and geothermal development. Technical assistance to address energy program environmental concerns, particularly those related to coal and hydro development, will also be a priority. A.I.D.'s comparative advantage in providing technical assistance for environmentally sound energy planning and development, and support for U.S. trade and investment and commodities, will complement major infrastructure financed by other donors, and will enhance the prospects for the transfer of U.S. technology and equipment.

3. Telecommunications*

A recent assessment for USAID confirmed that the lack of telecommunications is a particularly severe problem for business development. The Philippines is one of the most underserved countries in Asia, especially in areas outside of the the National Capital Region, where there is only one telephone per every 1000 inhabitants. Telecommunications services are provided by a mix of private carriers (98%) and public carriers (2%). One company, the Philippine Long Distance Telephone Company (PLDT), provides 90% of all services. Although PLDT is implementing a major expansion program, there will continue to be serious defects and deficiencies in Philippine telecommuncations services. The GOP, until recently, focused on meeting this deficit through a public sector-led approach. However, newly articulated GOP policies, supported by recently enacted legislation, encourage private sector participation and increased competition. Specifically, the Department of Transportation and Communications (DOTC) now endores the use of Official Development Assistance to help private telecommunications firms expand and upgrade systems. It is also promoting competition by requiring PLDT to interconnect with other companies, by adjusting revenue-sharing of the companies which are interconnected with PLDT to increase their share of revenues, and by awarding franchises of international 'gateways' to companies other than PLDT.

Although other bilateral donors have been active in the sector for many years, substantial opportunities exist for U.S. suppliers to participate in the provision of telecommunications equipment through blended credit programs. In 1991 PLDT will implement a $645 million X-5C program which will add 355,000 lines by 1993 followed by an X-6 program which will add another 500,000 lines by 1995.

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* This section is based principally on a draft report on the Philippine telecommunications sector prepared by Fred Bieganski, AID/W telecommunications engineer.

Concomitantly, the GOP is in the process on implementing a National Telephone Program financed by other donors, to serve 85 inadequately served cities and towns where there is an expressed unmet demand greater than 300 lines, and is embarking on a Municipal Telephone Program to establish public calling offices (PCOs) in 1100 municipalities unserved by telephones. The latter program, which is supported by the Municipal Telephone Act of 1989, will give private carriers franchised in the region the right of first refusal to establish these PCOs in each municipality. Official Development Assistance may be channeled to private companies to finance the establishnent of these PCOs. This program is estimated to cost $150 million its initial phase and up to $400 million to complete by 1995.

These programs offer significant opportunities for U.S. business to provide equipment provided that funds can be channelled to the private carriers on the same terms that funds are made available by other donors. Telecommunications would be one of the sectors covered by the proposed mixed credits facility. In any case, the USAID considers this sector a prime candidate for inclusion in MAI funding, with resulting opportunities for U.S. business.

C. Agriculture, Agribusiness, and Natural Resources Strategy*

Agriculture, fisheries and forestry constitute about 25% of the Philippines' gross domestic product. In 1970, the sector produced almost 29% of GDP. By 1982, its share had fallen to about 26%. However, the economic crisis of the mid-80's caused the sector's GDP share to rise to almost 30%. Of the 190 billion pesos of gross value added by the sector in 1988, crops were the dominant subsector at 56%, followed by fisheries at 20%, poultry at 10%, and livestock and forestry at 7% each.

Repeatedly, analysis has shown that inappropriate fiscal, trade and monetary policies, inadequate supporting infrastructure, excessive government interference in the marketplace, and uncontrolled population growth continue to be the most serious constraints facing this sector. These factors have interfered with open market operations and contributed to poor natural resource management. Agricultural exports have been particularly disadvantaged by the high peso value. The tariff structure on imported inputs hinders high value crop production and processing, timely distribution of inputs and outputs, and proper land management.

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* Dames & Moore International/Louis Berger International Inc./Institute for Development Anthropology: Sustainable Natural Resources Assessment - Philippines, September 1989.

Chemonics, Inc.: Agriculture and Natural Resources Strategy - Philippines, March 1990.

Past economic policies have concentrated infrastructure in urban areas, resulting in limited land transport systems and access to seaports outside the NCR. Inadequate road and port maintenance plus GOP policies which discourage open markets have pushed transportation's share of marketing costs to the highest in Asia. Open market policies and infrastructure investments will allow exploitation of regional comparative advantages, increase economic growth and enhance national food security.

1. <u>Agriculture</u>

About 3.4 million farms cultivate about 9.7 million ha. of land. A rapidly expanding population has put strong pressure on the land. Between 1961 and 1980, about 1.0 million ha. of additional land came into cultivation, but about 1.2 million additional farms began operating, causing the average farm size to fall from 3.59 ha. to 2.86 ha.

Rice, corn and coconut occupy 39%, 20% and 29%, respectively of the farm land and account for about 53% of the total value of crop production. Rice production grew at an average rate of about 5.12% per annum during 1969-79. By the late 1970s, the country had evolved to become a net rice exporter. However, the country reverted to a net import position by the mid-1980s as the general economy declined and the effects of pro-urban anti-agricultural policies emerged.

A GOP parastatal acts as the monopoly dealer for imported rice and has consistently depressed wholesale prices to protect urban consumers. As a result, the annual growth rate in rice production fell to 2.21% during 1980-88, while consumption grew at 2.69% per annum, closely following the population growth rate. During the last decade, the low growth rate has been due to a slight decline in harvested acreage and a moderate increase in yield. during 1980-87, the harvested rice acreage declined at an average rate of 0.46%, while production per ha. increased 2.59%. The country currently imports about 200,000 MT of rice annually. The experience over the last decade suggests that, over the next five years, consumption will more often than not exceed production; but as percentage of total domestic production (approximately 6 million MT), imports (3-6%) will be relatively small.

Corn production grew at an annual rate of 5.34% during 1969-79, and at an annual rate of 4.88% during 1980-88. About two-thirds of the corn supply is for animal feed (hogs/poultry). During 1969-88, corn feed utilization grew at an average annual rate of 8.07%, while corn utilization for food grew at only 1.02%. During the last decade, corn productivity has increased much faster than rice. During the last decade, corn productivity has increased much faster than rice. During 1980-87, corn acreage increased at an average annual rate of 1.86%, while production per ha. increased at 2.75%. Annual corn imports have fallen from a steady rate of about 350,000 thousand MTs in the early 1980s to a highly variable rate of about 60,000 MTs in recent years. Although corn production growth has been strong, even higher yields are needed to support the thriving livestock industry.

2. **Natural Resources**

Fisheries production has grown steadily from 1.7 million MTs in 1980 to 2.2 million MTs in 1987 with an estimated valued added of 37 billion pesos. Fish products have become an important export commodity, with sales growing from $138 million in 1980 to $407 million in 1988. About 50% of the 1988 export sales were for shrimps and prawns. However, export growth has been very erratic. In 1986, export sales fell to only $20 million. Prawn production has grown so fast throughout Southeast Asian during the past decade that prices are depressed and will continue to be weak for the next 3-5 years.

Annual log production has declined from 6.3 to 4.1 million cubic meters during 1980-87 During the same period, annual lumber/plywood production remained relatively steady at about 1.2 and 0.5 million cubic meters, respectively, while veneer production plummeted from 660,000 to 73,000 cubic meters, and pulpwood production increased from 390,000 to 618,000 cubic meters. Wood, cork and pulp exports declined from $292 million in 1980 to $190 million in 1988. During 1980-88, the gross valued added approximately tripled in crops, livestock and fisheries. The forestry subsector has grown less rapidly than the total sector because of generally depressed international prices and a rapidly declining forest base.

3. Agribusiness

The crops, livestock, fisheries and forestry subsectors generate a major demand for purchased production inputs and create a large market for product processing and marketing services. The sector produced 190 billion pesos of gross value added in 1988, to which agro-industries added 114 billion pesos in gross value of manufacturing services. The food and feed processing subsector purchases about 90% of all palay, corn, sugarcane and coconut production, and sells about 60% of its production to households. Other crops sell about 20% of their production to the food/feed processing subsector, and about 60% directly to households.

The livestock (particularly swine an poultry) subsector sell about 60% of their products to the food/feed processing subsector, and about 20% to households. Fisheries sell about 15% of their production to the food/feed processing subsector, and75% directly to households. The food-feed processing subsector has great potential to stimulate the productivity and value added of agriculture, fishery and forest production through its economic linkages with the general secondary/tertiary subsectors of the rest of the economy. According to a 20-sector aggregation of the Philippines Input-Output Model, every peso fo output by the food/feed processing subsector produces 3.75 pesos of output throughout the rest of the economy.

Sector Constraints

1. Agricultural Price and Market Controls

The GOP's price and market controls are a major cause of economic distortions in the sector, causing domestic production shortfalls, increased imports of food and feed grains, decreased private sector investment, and a weaker food security position.

2. Large and Inefficient Parastatal Agribusiness Complex

Widespread GOP ownership of corporations has substantially reduced competition and efficiency in the industrial, service and trade components of the agribusiness sector, thus constraining open markets. The inefficient and ineffective operation of these parastatals has become a heavy drain on public finances. The diversion of large fixed and working capital investments into unprofitable public enterprises distorts the capital market and further aggravates the budget deficit. Private sector confidence in the economy and interest in investing in agribusinesses will continue to be undermined until the GOP ceases being a major competitor, and in many cases of international trade, a monopolist.

3. Excessive Government Centralization

Centralization during the Marcos years resulted in excessive political and financial control over local government units and banking. Elimination of specialized government banks, targeted credit programs, and restrictions to branch banking are essential for private sector banks to operate in market centers, profitably service credit requirements, and mobilize local savings for local reinvestment.

4. Inappropriate Natural Resource Management Policies

Natural resources have been managed on a depletion rather than a renewable basis. This has seriously eroded the sector's contribution to economic growth and negatively impacts the environment. Rampant timber overcutting followed by slash and burn shifting and settled agriculture is fast transforming the uplands into unproductive areas devoid of the immense diversity they once possessed. Non-sustainable consumption of the mangroves and coral reefs is further diminishing species diversity and ecological stability in coastal zones.

5. Ineffective Technology Generation and Transfer System

An extensive public technology development and transfer system developed over the last 30 years is becoming increasingly ineffective. In addition to funding constraints, the system suffers from a lack of accountability for the economic utility of its output, and unarticulated demand for new technology by the private sector.

USAID Goal and Strategy

The Mission goal is to accelerate private sector-led economic growth in agriculture and improve national food security through increased reliance on open market mechanisms, financial and natural resources sustainability, and agribusiness development. The cross-cutting themes for the sector will be to enhance private and public sector efficiency, to increase privatization and comparative advantage, and to foster decentralization. The policy objectives of the sector are in the areas of (1) open markets, (2) sustainability and (3) agribusiness.

1 Open Markets

(a) Decontrol domestic markets and prices for agricultural inputs and outputs (e g., rice and wood) to stimulate private sector investment and competition in response to supply and demand.

(b) Divest agribusiness parastatals such as the Food Terminal Complex, the Paper Industries Corporation of the Philippines and the Philippine Phosphate Corporation to relieve budget pressure on the GOP and eliminate wasteful government competition with the private sector

(c) Reduce tariff and non-tariff restrictions on the export and import of agriculture and agriculture related commodities and equipment to stimulate sector growth according to the country's comparative advantage.

2. Sustainability

(a) Through greater reliance on open markets, increase land tenure rights and collection of economic rents, and ensure that renewable natural resources are placed under a sustainable management regime.

(b) Reduce the recurrent cost deficit for public sector development initiatives and infrastructure maintenance by increasing resource mobilization such as proceeds from tax enforcement and divestiture of parastatals and improved governmental operating efficiency.

(c) Devolve authority and responsibility to local governments to collect and expend taxes, set and pursue local development priorities and manage natural resources in their domain.

3. Agribusiness

(a) Strengthen the ability of commodity and business associations and other private sector entities to advocate policy reform and set investment priorities in research, infrastructure development, and finance.

(b) Establish linkages between private sector entities in the U.S. and the Philippines for purposes of market development, technology development and transfer, joint ventures and policy analysis.

(c) Reduce barriers to private sector entry and exit to increase overall competition in key subsectors such as fertilizer, paper products, stevedoring and arrastre services, transport and communications.

USAID Role

To achieve these policy objectives and address specific sector constraints, the Mission is designing three major sector program interventions. (The more general macro constraints to the sector of inappropriate fiscal, trade and monetary policies, lack of infrastructure, and population pressure will be addressed by economy-wide projects and programs).

1. Local Development Assistance Program (LDAP)

This proposed $50 million initiative will support GOP policy reform in nationwide decentralization by providing program support, small support grants, policy analysis, monitoring, evaluation and auditing services. The essence of decentralization in the Philippine context is to increase authority and responsibility, discretionary resources, and capacity of local government units to accelerate economic and social development.

This important open society initiative will enable local citizens to have a greater voice in local development issues, leading to improvements in basic service delivery, and financial and environmental sustainability of infrastructure and other investments. USAID's work with NGO's will complement this strengthened popular voice.

2. Natural Resources Management Program (NRMP)

Given the substantial donor resources already targeted for fisheries, coastal resource management and industrial tree production in the plains and low hill areas, the Mission program initiative in natural resources will be focused on improved tropical forest management in the uplands and will build upon experience gained in A.I.D.'s earlier projects in watershed management. The purpose of this proposed five-year, $125 million program is to: i) increase economic efficiency in the forest products and wood processing industries; and ii) promote both economically and ecologically sustainable natural resource management with special attention to tropical rain forests and biodiversity. The components of NRMP include performance based disbursements for the implementation of specified policy reforms, an NGO debt-for-development swap, technical assistance for policy implementation, research, monitoring, evaluation and audit services. Potential policy reforms to be pursued under NRMP include the collection of full economic rents for public forest resource use, deregulation of the sector's industrial and processing component to increase competition and efficiency, removal of tariff and non-tariff restrictions to the import of raw and semi-processed wood, divestiture of the parastatal which dominates the paper and newsprint subsector, and increased GOP funding of NGOs to work with forest communities and the informal sector on sustainable forestry management. In anticipation of this new program start, the Mission has funded a study to modify the national income accounts for forestry depletion to quantify the negative economic impact of past sector policies; this may be subsequently be expanded to incorporate other natural resource categories.

3. Agribusiness Sector Assistance Program (ASAP)

Based on the findings of this strategy, USAID will be examining a program to expand private-sector agribusiness investment and market-led agriculture sector growth. Tentatively, the first component will support agribusiness type R&D proposals; cooperation among local industry, research, financial and governmental entities to improve market-agroprocessing-trader-farmgate linkages; and selected Philippine-U.S. joint agribusiness ventures in planning, designing and securing financing. The second component will link performance-based disbursements to critical agribusiness policy reforms and be supported by technical assistance to strengthen the private sector's ability to carry out policy analysis and advocacy, build the GOP's overall capacity for market based sectoral management, and monitor progress in implementing agreed upon policy reforms. Potential reforms include the elimination of parastatals and cartels, tariff and non-tariff trade restrictions, market and price controls, input-output subsidies and constraints to local resource mobilization, and protecting intellectual property rights.

D. POPULATION AND HEALTH

1. Demographic Assessment and Health Sector Strategy*

The demographic assessment presents estimates of fertility, mortality, population and morbidity for the 1990s. The principal findings are:

a. In spite of fluctuations (32.1 for 1983, 45.3 for 1986, 36.2 for 1988) in the overall contraceptive prevalence rate (CPR), the total fertility rate (TFR) continues to decline from 5.92 in 1970 to 4.96 in 1980 to an estimated 3.73 for 1990.** Four possible explanations for this inconsistency between CPR and TFR trends are:

- there has been a steady increase up to 1986 (12.0 in 1978 to 18.0 in 1983 to 20.4 in 1986, little increase 1985-88) in the prevalence of modern contraceptive methods, but little increase since then (20.6 in 1988).
- there has been a decline of age specific fertility rates among younger women.
- after declining from 1975-80, the average age of marriage is again rising (24.0 for 1988).
- there is an increasing trend in fetal death rates (as high as 10-14% of all pregnancies in recent years), which may well be linked to the large unmet need for family planning.

b. Small changes in life expectancy at birth were experienced in 1975-84, but considering improvements in health inputs after 1985, life expectancy is expected to improve from 64.5 years in 1990 to 66.9 years by 2000.

c. The 1980 population of 48 million increased to an estimated population of 62 million in 1990, and is expected to increase further by 12-13 million to 74-75 million by 2000.*

d. The Philippines is moving slowly towards demographic transition with gradual changes in age composition expected over the next decade. From 1990 to 2000 the median age will increase from 19.9 to 22.4 years; the proportion of population 0-14 years will decline from 39.2% to 33.6%; the proportion of population 15-64 years will increase from 57.3% to 62.6%; the proportion of population over 65 years will increase from 3.5% to 3.8%; but the actual number of children 0-14 years will increase by 0.466 million (moderate fertility decline assumption).

e. In 1988, 37.8% of the population resided in urban centers compared to 37.3% in 1980.

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* University of the Philippines, Population Institute: An Analysis of Age-Specific Demographic Events in the Philippines: Trends and Prospects, February 1990.

** This is the moderate fertility decline assumption which, based on historic trends and preliminary results of the 1988 National Demographic Survey, projects TFRs of 3.73 for 1990, 3.25 for 1995 and 2.84 for 2000.

f. Under all seven assumptions used for trends in morbidity rates from 1990 to 2000 (see UPPI study, page 9 for desc ription of assumptions), the morbidity pattern for reported diseases will change slightly, and the ranking of incidence for ten leading causes of disease will remain stable. The range of expected proportion of sick population by type of disease for 1990 and 2000 under the seven assumptions is (see UPPI, page 29);

Type of Disease	Proportion of Sick Population, 1990	Proportion of Sick Population, 2000
Infectious	95.0% - 95.4%	92.4% - 94.5%
Degenerative	4.6% - 5.0%	5.5% - 7.6%

g. The distribution of projected morbidity by age shifts somewhat from young to the old, with the young still comprising the bulk of cases. For example, under the most optimistic of 7 morbidity rate assumptions (moderate fertility decline, for age structure; rapid decline in infectious diseases and moderate increase in degenerative diseases), the following changes in proportion of morbidity by age group are expected:

Age Group	Proportion of Projected Morbidity 1990	2000
0-4	27.8%	24.6%
5-14	33.6%	32.2%
15-29	14.5%	14.7%
30-39	7.6%	8.1%
40-59	9.8%	12.1%
60 +	6.6%	8.4%

h. In spite of continued reduction in the rate of increase in population, and under the most optimistic morbidity rate assumption, the projected morbidity for reported diseases declines by 9% from 1990 to 2000. Given that degenerative diseases, which are more difficult to prevent and much more costly to treat, are increasing as a proportion of the sick population by between 0.8% and 2.9%, while reported morbidity declines by a maximum of 9.0%, the financial demands on the health sector will continue to increase.

Implications

The demographic transition has begun to alter age composition and morbidity patterns, but these changes are occurring somewhat more slowly here than in other East Asian countries. The trends toward aging, waning of infectious diseases and ascendance of degenerative diseases will have profound implications for public policies over the next two decades. During the period of this Strategy Statement, the implications will be less pronounced.

• It should be noted that the Philippines has not had a census since 1980, and the 1990 Census results will not be available until 1991/92. Therefore, the Strategy Statement must use 1980 base population data updated with available (1983, 1986 and 1988) survey estimates. 1990 Census results are needed for validation of population size and inter-censal population growth. We are fairly confident about the 62.0 million population estimates for 1990 but less confident about the year 2000 estimates of 74-75 million. We believe these figures will be the minimum, and a more realistic year 2000 population range would be 75 to 77 million.

This means the country has time to prepare and an opportunity to help ensure sustainability. At this point, USAID must focus on ensuring continuity and momentum of the transition processes while we lay the foundation for financial viability.If successful, the growth in demand for public funds for the health sector could theoretically plateau by the year 2000.

Through this transitional period, continued attention to both fertility decline and child survival is essential to make USAID'S health care financing strategy work. If fertility does not continue to decline, the projected morbidity will drastically increase. If fertility declines moderately to TFR of 2.84 by 2000, and morbidity rates for infectious and degenerative diseases remain unchanged (1986 rates), the projected morbidity will increase by 13% from 1990 to 2000. If fertility declines rapidly, with the 1986 morbidity rates unchanged, the projected morbidity will increase by 8.5% from 1990 to 2000. If morbidity rates remain constant, rapid fertility decline will result in an increase in morbidity 4.5 percentage points smaller between 1990 and 2000 than under moderate fertility decline.

Without child survival interventions, infectious disease morbidity rates are expected to undergo a moderate decline. With child survival and other preventive health interventions, a rapid decline in infectious disease morbidity rates should be possible. For example, with moderate fertility decline, <u>moderate</u> decline in infectious disease morbidity rates, and moderate increase in degenerative disease morbidity rates, the projected morbidity for reported diseases increases 3.4% from 1990 to 2000. But, with moderate fertility decline, <u>rapid</u> decline in infectious disease morbidity and moderate increase in degenerative disease morbidity, the projected morbidity for reported diseases declines 9.0% from 1990 to 2000. Thus, the move from moderate to rapid reduction in infectious disease morbidity rates changes the 1990 to 2000 annual incidence of reported diseases from plus 3.4% (moderate decline) to minus 9.0% (rapid decline).

The overall USAID strategy for health and population will be to program in line with these trends. That is, continue to: (a) lower the unmet need for family planning by increasing the prevalence of modern contraceptive methods to lower the TFR; (b) focus on child survival interventions as the most cost-effective way to produce a rapid decline in infectious diseases; (c) pursue our health care financing strategy to improve sustainability of child survival programs; shift costs of prevention/treatment for all diseases, but particularly degenerative diseases, to the private sector; and improve the cost effectiveness and preventive impact of Medicare.

The health sector strategy for the Strategy Statement period emphasizes sustainability and efficient delivery of health services throughout the 1990s; improving efficiency of services through targeting, decentralization, and public/private sector partnerships. Appropriate health care financing is key to sustainability.

The major USAID health project of the 1980s, Primary Health Care Financing (PHCF), will terminate in 1990. This project, focused on the public sector, contributed significantly to institutionalizing the Department of Health's social marketing and communication capacity, its field epidemiology training capacity, a disease control program that includes commercialization of ORS, and strengthened immunization program management with an effective cold chain. Similarly our 2 year program of support to AIDS prevention and control is aimed at the same capacity building.

To complete our strategy in the 1990s, we are in rapid transition to projects and programs which contribute more fully to decentralization, private sector involvement and GOP policy changes consistent with the strategy of efficient, sustainable health services. Active policy discussions with DOH have resulted in a shift of our mode of assistance in health from project to performance-based program support, expressly to decentralize budget resources directly to the provinces and carefully target geographically or functionally underserved areas at high risk. The new Child Survival Program Support (CSPS) will lower infectious disease morbidity; it will further help sustain the child survival gains made through PHCF; it will ensure decentralization of resource planning, allocation and utilization; and it has created the leverage needed for policy and operational decisions which support private sector participation and innovative health care financing initiatives for the 1990s. It is envisioned that this mode of support will best serve our objectives throughout the 1990s. Annual progress reviews will modify methodology, as necessary, to maximize impact and sustainability.

Health Sector Finance and Population strategies for USAID are described more fully in the next sections.

2. Health Sector Finance Strategy*

In the past twenty years, real health spending has increased substantially faster than real GDP. Much of this growth has been due to the increased demand for services, the expansion of health care delivery systems, and the increasing sophistication of modern medicine. Demographic changes in the Philippines, combined with new technological developments, and increased demand for services will pose significant additional financing burdens on both public and private delivery systems.

The Philippine health system has been relatively successful in providing access to health services to the general population. Both the government and private purchasers, however, have begun to question the cost and effectiveness of the services they are purchasing. Efficiency and effectiveness issues have moved to the forefront of the policy debate in both the private and public sectors.

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* USAID/Philippines: Health Sector Finance Strategy, December 1989.

USAID has adopted the following health finance strategy:

1. Goal - to expand alternatives to government health services so that the GOP is able to allocate its resources to the poor most in need and to necessary public health activities.

2. Purpose - to continue the diversification of health care delivery and health care finance focused on the equitable and cost-efficient distribution of national health resources.

At present, USAID has two major health finance initiatives underway: one in child survival with an emphasis on insuring sustainability of preventive services to the GOP's most difficult to reach population groups; and the other with the Philippine Medical Care Commission (PMCC) to improve efficiency of health resource allocation for the salaried population.

The purpose of the financial sustainability component of USAID's Child Survival Program is to 1) develop a DOH health care financing strategy, 2) develop a DOH cost containment and cost recovery strategy, and 3) increase private sector service delivery alternatives.

The PMCC is financed from mandatory payroll deductions of employers and employees; it is estimated that membership of eligible workers and their dependents now covers 37 percent of the entire population. Since its inception, the PMCC has reimbursed beneficiaries only for the cost of hospital-based services, either in the public or the private sectors. The value of PMCC payments has fallen to around 15-30% of expenses incurred, and claims processing is seriously back-logged even though there are sufficient reserves.

Using the Technical Resources Project, USAID is providing technical assistance to PMCC to:

1. develop and implement a comprehensive data system on service use and the costs of providing these services;

2. develop policy options and recommendations for controlling costs, improving benefits, adding preventive care and expanding enrollment.

Recommendations from the PMCC and DOH for health care financing will be developed into a FY 1991 bilateral project which is expected to include:

1. demonstration projects for introducing outpatient services, including child survival, family planning, and other preventive health activities, as covered Medicare benefits;

2. demonstration health service delivery projects with the private sector, especially those built on risk sharing with insurance companies and HMOs;

3. assisting the DOH to develop the legal and regulatory basis for HMOs and promote the development of other prepaid health benefit packages;

4. assisting the DOH to explore and implement privatization options for specialty hospitals and curative health delivery facilities;

5. Other public and private partnerships to expand the roles of private health providers.

USAID will build beyond this initial involvement in health care financing as our work uncovers additional opportunities.

3. Population Sector Strategy

The estimated 1990 population of 62 million is estimated to be increasing at the rate of about 2.4 percent per year; about 1.48 million people are currently added to the country each year. Assuming continued moderate decline in fertility and mortality, the population will increase by at least 13.2 million to 75.2 million total before the turn of the century.

The growth rate has serious implications for economic gains that can be made under any development strategy. To stay even with population growth, food production must increase 40% by the year 2000; schools must absorb 300,000 additional children each year; the economy must create jobs for around 750,000 workers each year. It is likely that the Philippines will not have adequate human, physical, and financial capital to create meaningful long-term gains in food, nutrition, employment, health, environmental quality, and education unless the population growth rate is reduced. Regardless of any future success in reducing fertility, this challenge will remain serious until at least the year 2020, because the next generation of mothers and workers has already been born. Half of all Filipinos are under 20 years old.

A.I.D. and UNFPA are the only major donors involved in this sector. The World Bank has developed a $70 million Health Development Project loan with the DOH, which funds the employment of 2,000 midwives. There are numerous private donors, such as the International Planned Parenthood Federation, the Asia Foundation and the S.H. Cowell Foundation, that work principally with the Filipino private sector recipients. In addition, several AID/Washington-financed agencies are helping over 20 projects operated by private sector agencies, institutions or professional associations, with training, information, education, communication and motivation (IECM), research, technical assistance and institutional development. It is expected that this level of activity will expand over the next five years, largely through Mission buy-ins.

In May 1987, the GOP issued a Population Policy Statement based on the 1986 Philippine Constitution. The policy statement identifies program approaches that provide for the delivery of health, nutrition and family planning services to be integrated and treated as a vital component of comprehensive maternal and child health. Couples are to be given complete information on medically approved and legally acceptable family planning services to ensure a sound basis for their free, informed choices.

In August 1988, the Department of Health was designated as the lead aency for family planning services. In July 1989, President Aquino announced in her State of the Nation Address that the promotion of family planning and responsible parenthood would be one of three priorities critical to future success.

USAID Population Assistance is guided by the three principles of ongoing policy dialogue, expanded use of the private sector to achieve development objectives, and decentralization. In 1989, USAID and the DOH collaboratively developed a $62,427,000 five year (1990-1994) Family Planning Assistance Project (FPAP) as a follow-on to the Population Planning III Project which ended in December, 1988 Under FPAP, USAID will finance $40 Million or 64% of the project costs, with the DOH contributing $22.427 million or 36% of the cost of the project. The project's purpose is to increase the availability and utilization of family planning services. The core activity of the project is to enhance the ability of the public and private (commercial and non-profit) sectors to deliver family planning services. Four private sector avenues have been identified for support: support to firms to establish family planning clinics on their premises, contraceptive social marketing, support to family planning NGOs, and a pilot effort on franchising family planning and health care. Other components are generally supportive of service delivery: expansion of delivery; training; information, education, communication and motivation; logistics; contraceptive supplies; and research.

E. PVO Program Assessment*

The Aquino Administration has been under heavy pressure to rapidly increase socio-economic development throughout the Philippines. Budget and institutional constraints have resulted in a limited capacity within the GOP to carry out development activities. The GOP recognizes that private sector non-government organizations, including business interests and Private Voluntary Organizations, must play a central role in the execution of many development programs.

Further, principal figures in the Philippine private sector have become increasingly involved in the development process. They see the growth of the private sector and the growth of open markets as tied to the country's social and economic development. They are inspired to be 'good corporate citizens,' to give something back to the people of the Philippines. These 'captains of industry' founded Philippine Business for Social Progress (PBSP) in the 1970s, and now such people as the Chairman of San Miguel, the coordinator of the Economic Cluster at Malacanang, the Central Bank Governor, the Secretary of Agrarian Reform and former PBSP staff member, Florencio Abad and others provide leadership to some of the most active and talented PVOs in Asia. Another representative of this group is the head of the Ramon Aboitiz Foundation, Inc. (RAFI), backed by multiple businesses held by Aboitiz and Company and perhaps the most effective PVO in the country. Their success has led the Aboitiz businesses to become directly involved in national development projects.

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* Development Associates, Inc.: Strategic Assessment: PVO Co-Financing Project III-USAID/Philippines, December 1989.

These men and women, and many others like them, are substantially involved in the movement toward direct private sector involvement in development activities supporting the growth of the private sector and an open Philippine society. USAID has responded to this 'movement' through the Private Voluntary Organization Co-Financing Program and the Enterprise in Community Development (ECD) Project.

The PVO Co-Financing strategy focuses on the strengthening of local institutions: it advocates policy dialogue, attention to the potential of the private sector, and decentralization of responsibility for development to the local level as a means of pursuing the AID strategy of developing open markets, open societies. PVOs are encouraged to complement the efforts of local governments to enable LGUs to take on more responsibility vis-a-vis PVOs, to serve more people, to develop their resource base, and to magnify their social service and natural resource management programs. The development of Intermediate Institutions, cooperatives, and Muslim and other ethnic minority PVOs is greatly expanding the impact of the program.

Since 1980 USAID through PVO Co-Financing has made a total of 87 grants with a value of about $23 million to 56 Philippine and International PVOs. These grants have generated $9 million in counterpart funds.

Beginning in 1988 USAID began to move toward funding of Intermediate Institution (II) grants, with [illegible] % of PVO grant funds for IIs, which develop the ability of communities to interface with government agencies and to define their own opportunities and meet their own needs.

By 1989 the II focus expanded to include programs supporting small business promotion and PVO participation in policy development (Six II grants signed in 1989 accounted for 41%, or $2.4 million, of all grant funds obligated by USAID). Project CHILD, a USAID/Development of the People's Foundation funded II activity, achieved major changes in the Administration of Health Care policies of the GOP's Department of Health. The United Nations Development Program (UNDP) is now funding Project CHILD activities, based on the successful pilot, nationwide and in other third world countries.

USAID expects to continue to increase support for II activities with capable PVOs. The Mission is now working with RAFI and Aboitiz and Company to develop an II activity involved with natural resources management, implementing environmental rehabilitation activities in support of private sector development through participation by the private sector. If approved, this will be a first for the PVO and ECD programs and for USAID/Manila. Similar projects are being considered with PBSP, DPF, Jaime V. Ongpin Foundation, Negros Economic Development Foundation (NEDF), and Population Center Foundation (PCF).

In August 1989, a U.S. contract team conducted a 'Strategic Assessment' of the PVO Co-Financing Program. The primary focus was on finding whether the program is meeting three major objectives: (a) to increase productivity, raise incomes and generate employment among target beneficiaries; (b) to increase the capacity of PVOs and cooperatives to plan, manage and execute development activities, and (c) to facilitate the coordination of PVO activities with government organizations.

The team also addressed other matters such as project design, project modifications, attainment of subproject purposes, types of subprojects with the greatest impact, active participation of local participants, cost-effectiveness, sustainability and facilitation of linkages between PVOs and beneficiaries on the one hand and local government units and private organizations on the other.

The findings and conclusions were generally very positive. On whether the PVO Program overall is an effective delivery mode, the assessment team's conclusion was an unqualified yes.

In early 1987 USAID/Manila initiated the ECD Project, a unique program working with Philippine and American businesses to support participatory community development activities. Through ECD, USAID encourages the involvement of private business in the country's development.

The major advantage of this approach is bringing private companies' managerial and technical expertise to bear quickly and permanently, through transference to community organizations and individuals, on questions of choice and governance. This is the kind of assistance that a PVO or LGU would otherwise have to purchase, and benefit from only as long as it could pay for it. The financial management transfer built into this project alone justifies the investment in activities which open communities by promoting self-governance.

USAID provides grants funding up to fifty percent of total project costs while businesses provide in-kind and cash contributions, for projects ranging from microenterprise and vocational/technical education, to reforestation and marine conservation, to potable water, sanitation, day care and health care systems. The three-year projects are developed, proposed and implemented by the businesses in conjunction with the beneficiaries and coordinating government agencies.

Through ECD, USAID has initiated 11 grant agreements, seven in 1989 and one thus far in 1990, committing $3.2 million in USAID funds and an additional $3.2 million in private sector resources. An additional $3.3 million in USAID funds will be available for these activities in 1990.

The utilization of II's as a means of implementing larger-scale efforts through the ECD Project is planned beginning in 1990. Three major areas identified as potential II 'markets' for ECD are microenterprise development, vocational/technical training and environmental restoration/conservation supporting sectoral growth and policy development.

The USAID's PVO/NGO program will also be a key means of expanding democratic pluralism initiatives beyond the Asia Foundation judicial reform effort into broader areas. The Mission's next USDH position will focus on this opportunity; in the meantime we will rely heavily on TDY support.

V. MANAGEMENT ISSUES

A. Assistance Requirements

Although there have been improvements in the debt service situation, the Philippines' foreign debt remains a heavy burden on the economy. The debt to GNP ratio is expected to have dropped to 66 percent in 1989 from a high of 94 percent in 1986. The debt to export ratio is also expected to have decreased to 233 percent from 332 percent in 1985. Debt service in 1989 (without adjusting for debt conversions) equaled $3.6 billion, representing 29 percent of foreign exchange earnings from exports of goods and services (8.2 percent of GNP).

The March 1990 report of the Coordinating Council for the Philippine Assistance Program (CCPAP) estimates that in 1990-92 Philippine payments will average $4.4 billion per year. In percentage terms, however, the debt service burden will improve. From 1990 to 1992, the burden is expected to fall from 33.2 percent to 25.7 percent of exports and from 9.6 percent to 7.6 percent of GNP. Both the World Bank and the IMF consider the Philippines a good performer in managing the debt burden (and the economy).

The assistance requirements of the Philippines to meet external needs remain large. The January 1990 debt buyback arrangement which involved $1.3 billion worth of debt and the February 1990 Agreement for $700 million in new commercial money will alleviate short term needs but will not by themselves avert future balance of payments problems.

Foreign exchange requirements, including funds for the build-up of international reserves to three months' worth of imports, average $2.4 billion a year for 1991 and 1992, according to the CCPAP report. The report also projects that a residual financing gap of approximately $1.1 to $1.2 billion per year will continue after 1992 despite allowing for substantial medium and long-term capital inflows. A portion of the financing gap could be covered through additional borrowing from commercial sources, including trade credits. Larger private capital flows, including direct foreign investment, and rescheduling of debt service to official creditors could also cover part of the financing needs.

Substantial progress has been made recently in securing official external financing for the medium-term balance of payments situation. Significant new loan commitments have been received under the Multilateral Assistance Initiative/Philippine Assistance Program (MAI/PAP). Total pledges at the Tokyo meeting in July 1989 amounted to $3.5 billion for 1989/90.

Regarding the U.S. bilateral program, in order to successfully implement the strategy, USAID is planning on a consistent flow of financial resources at the AAPL level of approximately $55 million in DA, $160 million in ESF, $200 million in the Multilateral Assistance Initiative (MAI), and $35-50 million in PL-480 Titles I and II.

Based on USAID projections, $55.0 million in DA and $160.0 million in ESF will be needed in FY 1990 to cover incremental costs of ongoing projects and start up costs for new projects. In FY 1991 these requirements will be approximately the same. The projections take into consideration the magnitude of the mortgage for projects authorized prior to FY 1990 and the need to design projects in accordance with the MBA, current Mission strategy and Bureau themes. If the AAPL is not maintained at these levels, USAID runs the risk of not being able to implement the planned strategy, or meet the MAI and MBA pledges.

The FY 1990 shortfalls create both diplomatic and strategy problems. Insread of the $160 million of ESF anticipated under the best- efforts pledge, only $124 million is currently being made available. In the case of the SI/MAI program, it appears that the FY 1990 level will not reach the originally planned $200 million, but will be $160 million. This puts the Mission in a precarious position for the first year under the MAI, when one of the two donor countries which led the initiative and convinced other donors to follow is not able to meet its first year commitment.

B. Portfolio Management Issues

USAID/Philippines is in the process of restructuring its portfolio from one heavily committed to institutional development to one which includes an appropriate mix of institutional development and performance-based disbursement activities. By the end of FY 1990, there will be approximately 30 active projects and non-project activities in the USAID/Philippines' portfolio, with nearly one-half begun since FY 1987. In addition, some projects developed prior to FY 1987 have been refocused on current priorities and given operational guidelines which expedite decision-making, reduce paperwork and accelerate disbursements.

The restructuring of the portfolio has resulted in a greater emphasis on the interrelationship between the objectives and goals of our distinct activities. For example, the policy and administrative reforms included in the Support for Development Program assist in providing the environment needed to open new opportunities for the private sector, improve the efficiency of basic services and provide for more economic response to new and rehabilitated infrastructure.

Deobligation/Reobligation

Another management issue related to our portfolio is deobligation/reobligation. The Mission has been aggressive in utilizing the deobligation/reobligation authority to shift needed resources where they could be more productive. From FY 1985 to the second quarter of FY 1990, USAID deobligated $135,374,949 from 28 ongoing projects. Of this, $80 million occured in 1986 to provide a large budget support program to the new Aquino administration. Since 1988, deobligations have been directed at tightening project management and bringing the portfolio toward the current strategy. This has involved shifting funds from slower to faster moving, higher priority activities in the private sector by phasing out non-performing projects or project components. There were no deobligations in 1987 or early 1988, but since the last quarter of FY 1988, $36.9 million has been deobligated for these purposes.

USAID will continue its agressive deobligation policy, and recently discussed the balance of 1990 deobligations, currently estimated at $14 million, with Secretary of Finance, who was supportive.

Project vs. Program

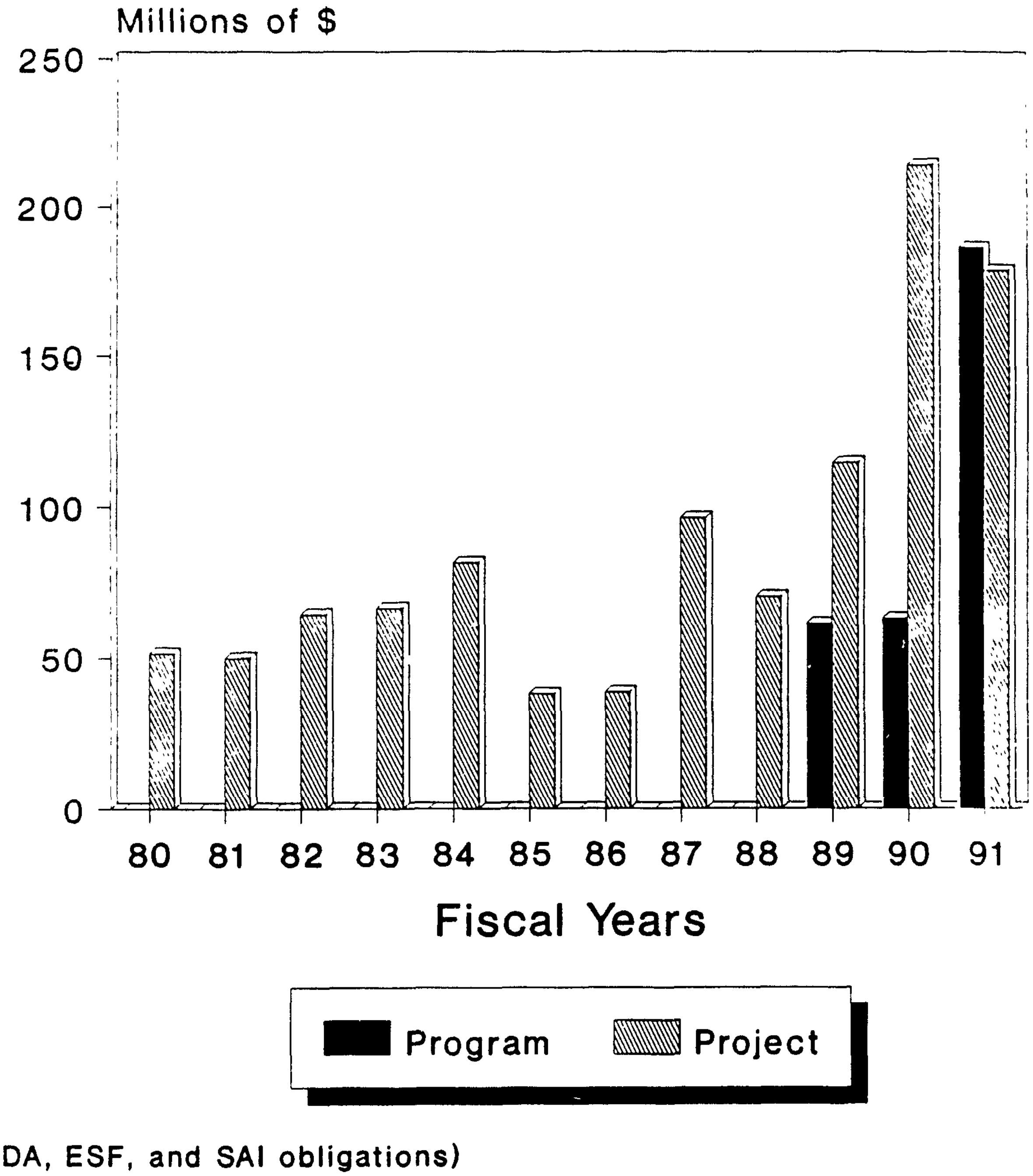
Continuing high value projects require a considerable amount of oversight on the part of Mission personnel. During project implementation, new opportunities are identified and areas of focus are revised. In addition, some GOP implementing agencies remain unable to provide qualified staff knowledgeable of AID procedures to implement activities over the life of a project, and the Mission absorbs a greater administrative oversight burden than is desirable given the large and increasing portfolio.

The current portfolio is being realigned to accommodate the A.I.D. objective of promoting open markets and open societies. The heavy policy emphasis of this strategy, as well as the level of resources anticipated, will require considerable effort during design stages. Implementation will theoretically be less staff intensive, although the jury is still out, and savings may well prove to be less than anticipated. Where the program mode is possible, performance-based disbursements should also allow more rapid and predictable pipeline drawdown. For each new activity, the Mission will consider the use of fast-disbursing programs wherever possible, although it is clear that for some activities the traditional project mode will be more appropriate. (See paragraph).

Funds Flow: Although GOP Regulations require grant assistance to be financed through cash advances, there are frequently long delays before the advances reach GOP implementing agencies. As a result, the implementation of USAID projects has been seriously affected. The delays have also slowed down the reporting of liquidations and the release of subsequent advances to GOP agencies. A study of the advance system by a local CPA firm, financed by USAID, showed that the delays were caused by the GOP's Bureau of Treasury, Department of Budget and Management and the implementing agencies themselves. The study also made several recommendations to improve funds flow, and the GOP agreed to implement these recommendations. Although some improvement was evident during FY 1989, the GOP funding mechanism continues to be cumbersome and far from satisfactory.

These same fund flow problems are not evident when monies utilized are GOP appropriated funds. Given the continuing problems with the advance system, the Mission is discussing with the GOP moving to initial financing through regular GOP channels, with subsequent reimbursement from USAID. The GOP has responded with an interesting reimbursement scheme. The Mission is reviewing this proposal with DBM, and will continue to pursue this initiative. While the reimbursement method is a logical step in terms of financial management, it could result in delays in getting needed funding to appropriate projects if there are GOP cash flow problems.

Program/Project Split
Excluding Cash Transfers



(DA, ESF, and SAI obligations)

Absorptive Capacity: In October 1989 at a Mini-Consultative Group meeting on project implementation, the GOP unveiled a new Official Development Assistance (ODA) management system to streamline the ODA process. In addition, the GOP has focused on accelerating the use of donor resources by improving implementing agencies' capabilities to implement projects, monitoring projects to identify problems and work out solutions, and improving mechanisms for the release of counterpart funds to implementing agencies. The GOP has made good progress on these measures, but the GOP bureaucracy is still slow in responding to policy initiatives and pinpointing responsibility. Putting selected activities on a 'fast track' is still difficult. The Mission will continue its efforts through negotiation and studies to increase the absorptive capacity of the GOP to design, implement and monitor projects and programs. In designing new activities, USAID will take carefully into account the GOP capacity to perform.

Pipeline

As of December 31, 1989, USAID's active portfolio consists of $831 million in obligated funds of which $519 million have been spent. As of December 31, 1989, the pipeline was estimated to be $312 million. This pipeline consists of $136 million in DA and $176 million in ESF funds. (See graph).

DA & ESF Pipeline, Obligations and Expenditures
FY 1986 - 12/31/89
($ Million)

	FY 86	FY 87	FY 88	FY 89	12/31/89
Pipeline Start	276	176	331	247	413
LESS:					
Expenditures	369	91	123	161	101
Deobligations	70	---	16	18	---
ADD:					
NOA Obligations	235	246	40	338	---
Reobligations	104	---	15	7	---
Pipeline End	176	331	247	413	312

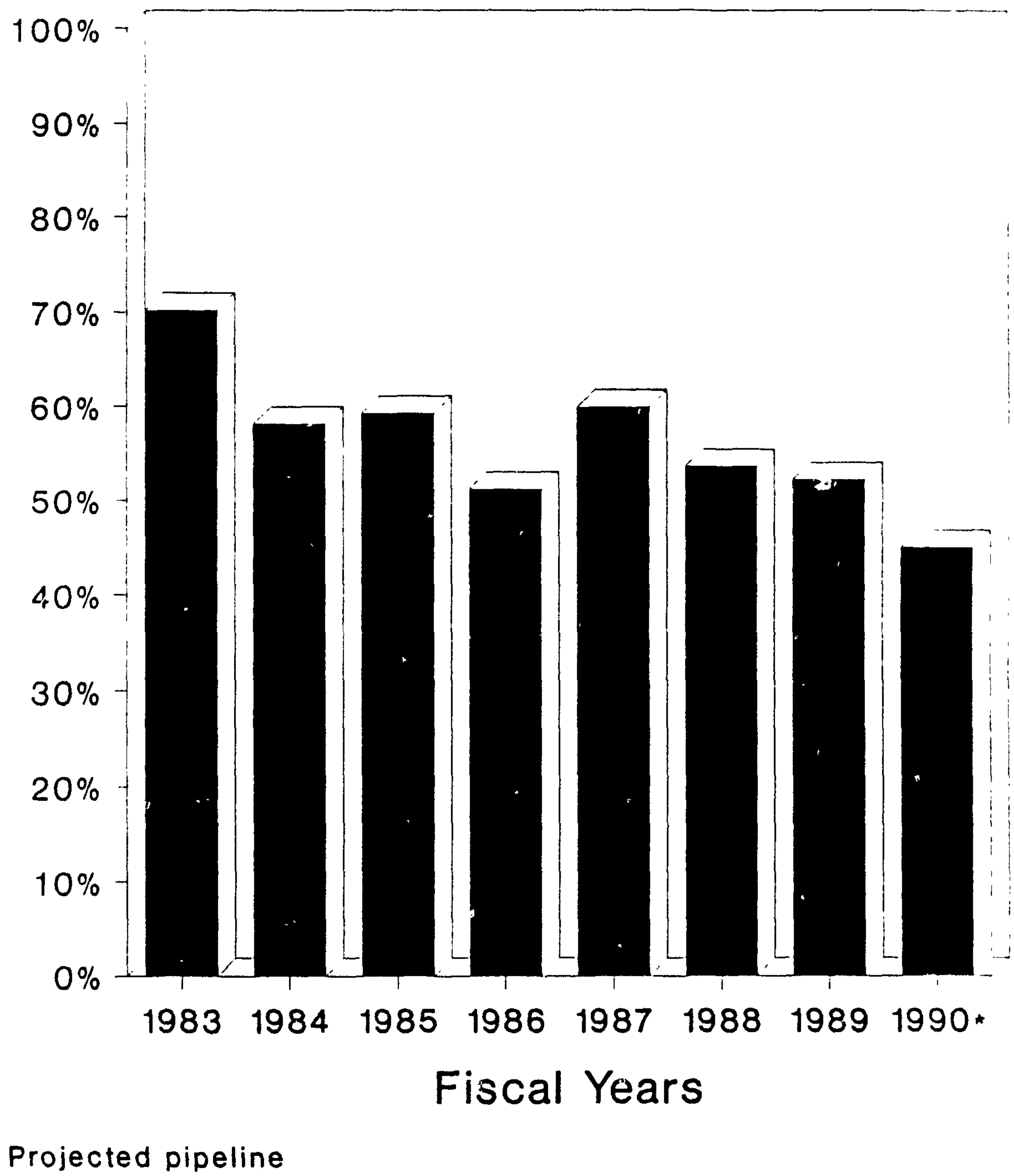
After a slow and cautious beginning under the new administration, problems with the Presidential Commission on Audit and the like, there has been a marked improvement in expenditures in FYs 1988 and 1989 and the first quarter of FY 1990. With the steps taken, as noted above, it is expected that this trend will continue.

Project Assistance Expenditures
($ Million)

	1986	1987	1988	1989	12/31/89
DA & ESF	24	16	48	36	18

Project expenditures tripled (from $16 million to $48 million) between FY 1987 and 1988. In FY 1989, project expenditures actually declined (from $48 million to $36 million). However, during the first quarter of FY 1990, project expenditures were $18 million (over half FY 1989 expenditures for the entire year).

Pipeline for Active Projects as % of Cumulative Obligations



Under the ESF category, over 100 subprojects have been contracted for or are out for bids. Over 30 of these activities are presently under construction. It is expected that, of the 100 subprojects, 80 percent will be completed by the end of FY 90.

Program Assistance Expenditures
($ Million)

	1986	1987	1988	1989	12/31/89
DA and ESF	345	75	75	126	83

Program assistance expenditures have increased consistently since FY 1988. This increase is due to USAID's emphasis in supporting GOP policy and administrative reforms with fast-disbursing programs. It is anticipated that program assistance expenditures will continue to increase at a pace commensurate with the GOP's implementation of its economic and policy reform program.

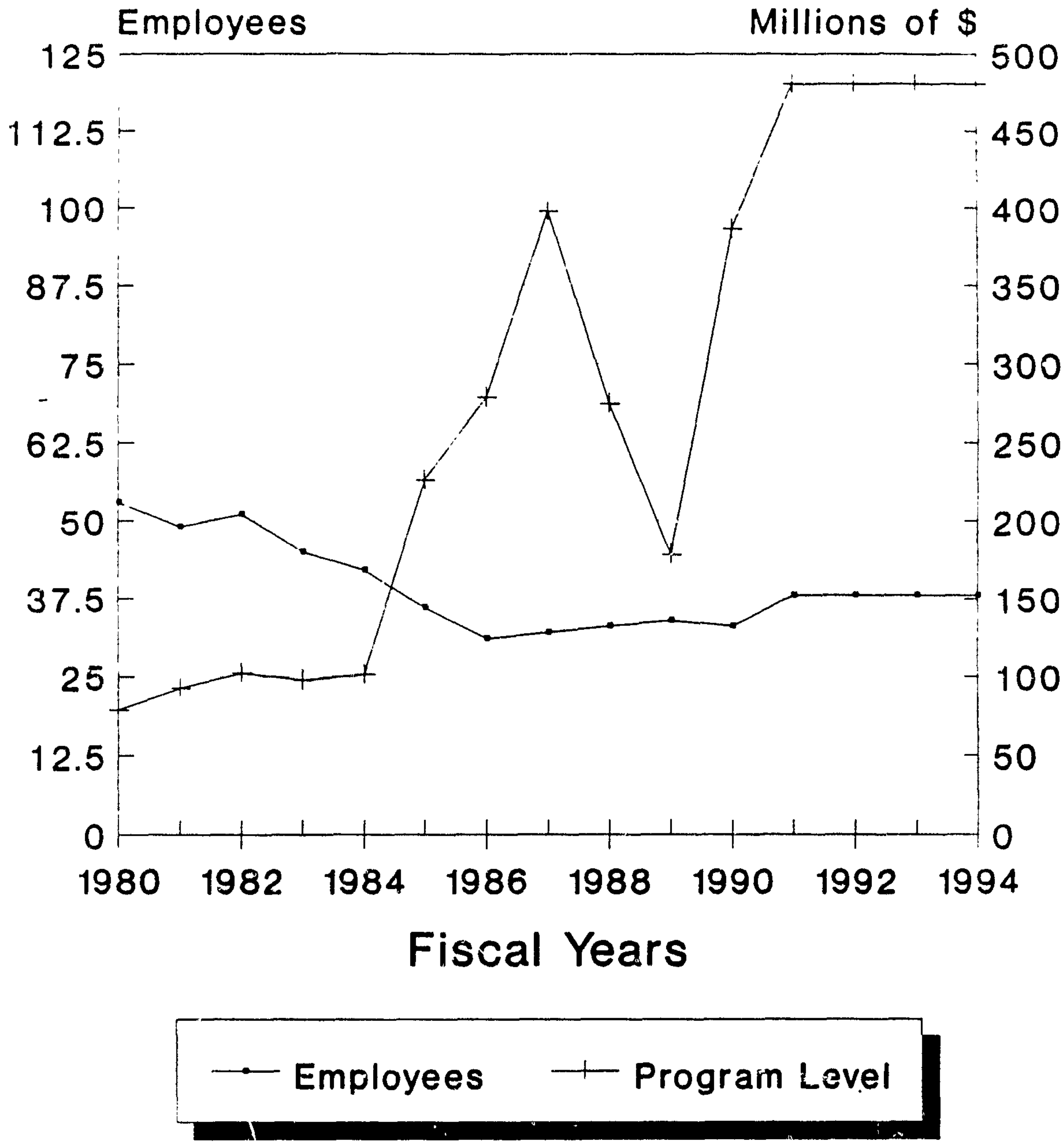
The current portfolio is being realigned to accommodate the A.I.D. objective of promoting open markets and private sector-led economic growth with the pipeline issue in mind. Ten new activities are currently being designed and two on-going activities are being redesigned. To alleviate the pipeline build-up inherent in adding a substantial number of new activities to the portfolio, some are being designed as program assistance and should therefore disburse resources relatively quickly, assuming good performance (i.e., Natural Resources Management, Local Development Assistance and Policy Support).

C. Staffing

The Mission is setting ambitious open markets/open society objectives. Although funding levels have increased significantly, staffing levels have not grown commensurately due to increasingly serious security considerations. In the face of an overall downward trend in total U.S. staff levels in Manila, the Embassy has agreed to establish three new USDH AID positions and to allow the trade-off of two informal intern positions for USDH, bringing total USDH staff from 35 to 40. The work load associated with dollar per staff ratio (either USDH alone, or including PSC and institutional contractors) nonetheless remains the highest in the Agency. Consequently, we have to accomplish more within constrained staff levels, despite an operating environment which requires close monitoring and high professional standards of accountability. (See graph).

USAID continues to implement the 'Mission Vision' which resulted from the 1989 retreat and which facilitates operations by improving teamwork, delegating more authority to the project level, and by increasing the use of data management systems and training. Following the 1990 retreat, a Retreat Action Committee has been set up to deal with a follow-on agenda to consolidate recent gains and establish new objectives.

USDH EMPLOYEES
AND PROGRAM LEVEL



Security factors must be taken into consideration not only in staff levels, but in selecting officers to fill positions. The Mission needs highly motivated personnel with broad-based development experience, a keen perception for windows of opportunity, experience in implementing new program modalities, and the ability to operate under continuing pressure. It will be necessary to recruit technical staff who also work comfortably with creative design, economics and policy, and rigorous analysis. Limited staff also means that we can afford no gaps between assignments, will continue to need a significant number of high quality TDYers, and will continue to rely heavily on experienced Washington assistance.

The USAID staffing strategy, in consultation with the Bureau, must facilitate: (1) accomplishment of agreed-upon developmental objectives, (2) accountability for the large resources flowing into the Philippines, (3) dealing with new programming modalities, (4) being responsive to security concerns, and continued priority AID/W attention to staffing needs. In summary, the strategy consists of the following:

1. Upgrading staff capability by selecting top level US and FSN replacements as incumbent personnel depart;
2. Looking where possible to assistance vehicles which are less staff intensive;
3. Continuing to use new and more effective ways of doing business, and delegating authorities both to USAID/Philippines and within the USAID as far as possible without sacrificing quality and effectiveness;
4. Maximizing use of our gifted FSN employees;
5. Looking to the private sector and PVO/NGOs to implement projects/programs through new modalities; and
6. Relying on the use of AID/W PSC and TDY assistance for short-to-medium term tasks to augment existing USDH personnel.

D. Operating Expenses

The Mission is pleased to have negotiated a firm local currency Trust Fund agreement with the GOP last year, thereby helping alleviate the Agency's OE problems. However, constraints on the levels of dollar Operating Expenses have a direct affect upon the Mission's ability to appropriately manage and maintain adequate accountability over the program. This situation is especially worrisome in light of the increasing size of the program. Through a series of initiatives, USAID has thus far been able to manage within constrained levels of both personnel and OE funding. However, there is a serious concern regarding the Mission's ability to adequately manage the USAID portfolio given this trend.

The dollar OE level for 1990 has been established at $1.25 million. The targeted figure at the time of the preparation of the Annual Budget Submission was $1.75, which was in itself a difficult level for the Mission. Other sections of this document discuss the use of TDY and PSC assistance in managing the program within limited staffing levels. This approach, however, requires funding from the dollar OE budget, and cannot be solved through the use of local currencies.

This Mission is attempting to lessen the management load on mission personnel through judicious use of program-funded management services. The ability to do this, however, is also limited due to the legislative requirement that most direct AID management be financed from OE funds.

The Mission has been successful in negotiating an agreement with the GOP covering local currency trust funds which should provide adequate levels for the next two years. The uses of these funds have been expanded to lessen the strain dollar requirements through items such as procurement of data processing equipment and financing certain international travel costs. While this has helped to ease the burden of operating within constrained dollar levels, it is not a practical solution to OE costs of TDY and PSC assistance and cannot be used to finance items paid for in other than local currencies. Further, in spite of the recent agreement, the trust fund continues to be a source of extreme concern to the Philippine government; the Mission will be very conscientious about uses, and limits on the availability of these funds in the future remain a very strong possibility.

VI. SPECIAL TOPICS

A. Donor Coordination and the MAI

1. Other Donors

The USAID maintains close contacts and working arrangements with other major donors to avoid duplication, to achieve coordination on major policy issues and projects, and to ensure effective and thorough coverage of needed development activities and reforms. One of the central purposes of the Multilateral Assistance Initiative (MAI) is to increase project and policy coordination among donors. Under the MAI coordination has improved, particularly within the 'core group', but the full synergistic potential of coordination has not yet been realized.

The largest donors to the Philippines, in order, are Japan, World Bank, Asian Development Bank (ADB) and the United States. The International Monetary Fund (IMF) also provides major assistance; Italy, Canada, Australia, the Netherlands, and U.N. agencies have significant programs in the Philippines.

Multilaterals

The IMF has the lead role on macro and stabilization issues. Its Extended Fund Facility (1989 value of about $865 million) and Compensatory and Contingency Financing Facility (1989 value of approximately $375 million) address several economic issues: a substantial increase in investment and efficient resource use, a market-determined exchange rate, the continuation or completion of recent structural reforms, financial sector reforms, reduction of the national government's budget deficit, emphasis on an effective and integrated program of monitoring and controlling the exploitation of forestry resources, and addressing poverty problems.

The World Bank provides significant development assistance to the Philippines, totalling $495 million during June 1988 - May 1989 and at least $500 million (excluding the debt restructuring assistance) during June 1989 - May 1990. The bank takes the lead role in several sectors. It provides support for the country's reform programs for government corporations, financial sector, energy sector and housing sector.

The Asian Development Bank's assistance program for 1989 was $566.9 million. Of the total, $548.4 million was allocated to loans for seven projects, $11.5 million to the private sector loans and equity program, and $7.0 million to 22 technical assistance recipients. The program emphasizes the power, forestry, water, and small and medium industries sectors. While ADB is beginning to provide sector assistance, its strength and major role is still in capital intensive projects.

The UNDP supplied $5.8 million in assistance in 1988, excluding aid the Philippines received from regional UNDP programs. Sectors receiving the most emphasis were agriculture, forestry, and fisheries and also general development issues, policy, and planning. Other UN agencies provided $8.9 million in assistance in 1988, concentrating on social conditions and equity issues as well as the population sector.

Bilaterals

Japan provides assistance through three organizations: JICA (Japan International Cooperation Agency), OECF (Overseas Economic Cooperation Fund), and the Japan Export-Import Bank. In 1988 JICA provided $70 million in capital grant aid and $60 million in technical cooperation. The OECF's 16th yen loan package of 1989 totalled approximately $850 million. It emphasized projects in such areas as irrigation, water supply, flood control and provincial roads, along with a loan for the financial sector, especially commercial banks.

The Japanese Export-Import Bank provided three loans in 1989. These included $300 million of IMF parallel lending for balance of payments support and two direct overseas investment loans for joint ventures worth a combined total of $64 million. The Japanese have been an important supporter of the Aquino Administration through the substantial provision of resources and of policy reforms through co-financing of World Bank and IMF programs.

Other bilateral donors, especially as a group, also provide significant amounts of aid. They generally have been responsive and supportive on policy and resource issues. Italy committed $392 million in assistance to the Philippines over 1987-1989. Of this, $202 million was in the form of grants and $190 in loans. The sectors receiving the largest shares of the funding were infrastructure, agriculture, and energy.

Australia supplied about $25 million in assistance during the July 1988 - June 1989 period. Approximately 80 percent of this amount is directed to the bilateral program. Natural resources and education and training are the largest sectors addressed by the aid program. The Netherlands provides approximately $25 million per year in assistance to the Philippines, assisting primarily the CARP-related and rural development sectors. Only a small part of this aid is in the form of technical assistance. Canada's assistance program has provided approximately $19 million in each of the last two April - March fiscal years. About 40 percent of this amount is for commodity projects which provide balance of payments support.

2. Multilateral Assistance Initiative

The formulation of the Multilateral Assistance Initiative (MAI) serves to enhance donor coordination and burden sharing and to focus assistance to the Philippines on creating a policy environment which stimulates private sector-led growth.

Discussions between the U.S., the Philippines, Japan, the IMF and the World Bank, the 'core donors', culminated in a World Bank-led Consultative Group Meeting at which representatives of nineteen countries and six international agencies met in Tokyo in July 1989 to launch the MAI. At the closing session, the World Bank announced that total pledges amounted to $3.5 billion, even more than earlier IBRD estimates of about $3.0 billion. Pledged aid was more than twice the total assistance of some $1 6 billion pledged at the last CG in February 1987

Assessment of economic program. Donor countries have acknowledged the achievements of the GOP's early economic reform program and endorsed the strong commitment, and equally strong need, to continuing that reform effort. In this connection, the GOP reached agreement with the IMF in May 1989 for a three-year Extended Fund Facility. Significant challenges remain, however, and in many ways the reform steps still needed are more difficult than those the GOP has already undertaken. Of great importance, for example, is the need to attract high levels of private sector investment. To do this, the GOP must maintain a competitive exchange rate, strengthen its financial sector, rapidly pursue privatization, mobilize domestic resources, and make public investment programs more efficient.

Implementation. The donor community has emphasized from the beginning that launching the MAI is only a first step. The burden rests with the GOP to make effective and efficient use of donor funds to achieve sustained, broadly based growth led by the private sector. The ability of the Philippines to absorb the higher levels of assistance pledged has been a major point of discussion in both formal and informal meetings since Tokyo. A number of donors have expressed concern about the ability of the GOP to improve its administrative process. There has been considerable discussion of constraints to project and program development and implementation, but also of new measures taken by the GOI and donors to improve utilization.

Of particular interest are the organizational changes affecting the administration of foreign assistance programs. In October 1989, the GOP hosted a meeting which was widely attended by the donor community. The GOP reaffirmed that all foreign assistance will be coordinated by new Committee on Official Development Assistance (CODA) as well as of the Coordinating Council on the Philippines Assistance Program (CCPAP). The GOP announced a 90-day program to institute a series of additional measures to simplify and improve its administrative procedures in order to ensure that assistance is used rapidly, efficiently and effectively. During the March 1990 core group meeting, the GOP distributed a report on 19 actions that had been taken, and are now being implemented to deal with donor concerns raised during mini-CG on improving implementation held in October.

At the core group meeting held in March 1990, to review overall progress on targets established in the PAP framework paper, donors expressed concern about certain critical areas of structural and macro-economic importance, but were impressed by the GOP's grasp of issues and announced economic package.

The positive reaction to the announced economic reform package was buoyed considerably by the G.O.P.-declared strong intentions to move immediately and to complete the major thrust of the program within a 100-day, GOP-established target timeframe. Another core group meeting will be held in June 1990 to review action under this new GOP package, as well as progress on IMF program targets.

Environment and Natural Resource Management. The need for more effective management of natural resources has been a pronounced theme by the GOP and most donors, particularly the U.S. and the Japanese. At the Tokyo CG, it was agreed that a separate technical meeting on this issue would be held early in 1990.

Over 150 participants from 26 bilateral and multilateral donors, Philippine and U.S. environmental PVO's and GOP functional and line agencies attended the meeting on February 13 and 14, 1990. Both the Coordinating Council for the Philippine Assistance Program (CCPAP) and the Department of Environment and Natural Resources (DENR) were cited for the significant progress made since 1986, particularly by DENR in project/program implementation, absorptive capacity, greater NGO involvement, decentralization of implementation, enforcement of environmental regulations and the pursuit of policy reforms for promoting sustained use of the country's natural resources. Unveiling the Philippines Strategy for Sustainable Development (PSSD), a conceptual framework for addressing the natural resources problems, was one of the highlights of the meeting. This conceptual framework met with general donor approval as it focused on: a) addressing the need and interest of the small indigenous resource users as well as the general public; b) providing incentives for private industry to utilize the country's natural resources in a more efficient and sustainable fashion, while diminishing their control over these resources; and c) identifying and implementing measures that will help rehabilitate the environment.

However, it was noted that the GOP, in close collaboration with the donors, needs to establish clear priorities within and among these broad areas. Planned follow-up actions that were consequently identified include: additional donor and GOP meetings on priortiezed actions of the PSSD; accelerating enforcement efforts; and consolidating the contributions of the for profit private sector, non-government organizations, government organizations and donors. This will require close attention to assess progress and further collaboration among donors. Planned follow-up actions identified were: specified donor meetings on prioritized actions of the PSSD, accelerating enforcement efforts and consolidating the contributions of for profit private sector, non-government organizations/government organizations and donors.

Agrarian Reform. The donor community is supporting the GOP emphasis on providing support services, credit and infrastructure as well as land transfers under the agrarian reform program.

However, the Agrarian Reform Program is complex, ambitious, administratively demanding, and involves very sensitive domestic political issues. Many donors expressed interest in the development of specific projects to help support the implementation of the Program. A follow-up 'mini-CG' on this subject will likely be held in the summer of 1990.

3. USAID MAI Assistance.

In Tokyo the U.S. made a multi-year pledge to the MAI of $1 billion. A.I.D.'s efforts are being directed largely at continuing the policy reform initiatives, already launched, aimed at creating sustainable, broadly based economic growth in order to increase opportunities for the private sector through open markets and economic diversification. Our assistance will focus generally on private sector activities and infrastructure which opens opportunities for U.S. business rather than the social services aspects of the Program. Broadly based growth will lead to widespread benefits and increased employment for the Philippine people. The Mission will be prepared with more traditional activities in telecommunications or power, the sectors most appropriate to the mixed credit facility, should the mixed-credit facility not materialize.

Specifically, A.I.D. resources are targeted at:

-- supporting structural reforms to increase opportunities for widespread growth led by the private sector;

-- increasing the involvement of the private sector in the development process;

-- removing policy constraints to open market-led growth and private investment outside of Manila;

-- improving the management of the nation's natural resources;

-- developing nationwide infrastructure necessary for broadly based private sector-led growth (e.g., ports, telecommunications, markets, power and air and waterway linkages);

-- enhancing private sector involvement in more efficient and effective delivery of basic services.

Use of FY 1990 MAI Funds. The A.I.D. Mission is well along in its programming of MAI funds:

-- PAP Support - $25 Million. An initial tranche of $11 million was obligated in January. Advertising for bids for the major feasibility study contracts is underway. The second tranche of $14 million is scheduled for obligation later in the fiscal year.

-- Policy Support - $40 Million. USAID has been holding extensive discussions with the new GOP economic team to identify additional policy reform efforts which can be undertaken. The exchange rate and the Bureau of Investments, and privatization are strong candidates. Discussions should be concluded in the third quarter of FY 1990.

-- Mindanao Area Development - $35 Million. Roads which are basic to further development of the General Santos area have been identified. Discussions with the government on expedited contracting mechanisms have been concluded. Approximately $20 million of the total will be channelled through the existing Rural Infrastructure Fund Project in an effort to begin activities immediately.

-- Natural Resources - $30 Million. The PAIP for the Natural Resources Management Program was sent to AID/Washington on February 21, 1990. It proposes a policy-driven natural resources management program with two purposes: (a) to increase economic efficiency in the forest products and wood processing industries; and (b) to promote the economically and ecologically sustainable management of the Philippines' natural resources with special attention to tropical rainforests and biodiversity. The basic premise of this initiative is that natural resources, particularly forest resources, which are economically and ecologically sustainably managed, can continue to be a significant and direct contributor to the economy and society of the Philippines. For-profit private sector and non-government organizations are keys to the success of USAID's assistance to the sector.

-- Mixed Credit Facility. The Mission is actively discussing with Washington the establishment of a mixed credit facility under the MAI to assist U.S. firms to compete more competitively for major infrastructure projects in the Philippines, particularly in telecommunications and power. Washington has assumed responsibility for providing policy guidance and structure for the facility, which has been discussed in broad terms with the GOP. Leveraged Exim 'war chest' additionality is essential to successful negotiation.

B. Democratic Pluralism Initiative

The recent Bureau Democratic Pluralism Initiative (DPI) is well suited to the Philippines. The ascension to power of Corazon Aquino in February 1986 brought about fundamental political change. The six-year economic development plan adopted by the GOP in 1986 is reflective of the principles embodied in the DPI: a respect for human rights, social justice, and greater efficiency and reduced government intervention. The plan emphasizes a strong free-market, private-sector orientation.

USAID played a role in helping establish political liberties in the Philippines, providing crucial budget support during the critical early years of the Aquino Administration in support of vital policy reforms as well as assistance for monitoring the snap elections in 1987. USAID also funded commodities and personnel support costs related to voter registration for the Commission on Elections.

Despite the strong record of achievement in restoring formal political structures and basic civil rights, there is much that can be done to consolidate achievements in democratic pluralism and advance the objectives further.

Corruption, oligopolies, an inefficient and overly bureaucratized judiciary, and problems of law and order continue to show the potential to undermine restored democracy in the Philippines. Replacing vested interests and ways of doing business with the intrinsic tenets of democratic pluralism is a gradual and long-term process. Remaining tasks critical to safeguarding existing political gains and increasing effectiveness of present institutions are the creation of a more open and supportive, market-oriented economic environment, stronger private sector and NGO organizations, a strengthened judicial system, and more effective delivery of basic services. In moving to capitalize on this opportunity, the USAID will be requesting significant Bureau and Agency backstopping and direct support.

USAID Role

The major emphasis of USAID for DPI is: (1) voice - strengthen NGOs and private sector organizations that help the functioning of democratic institutions, (2) governance - improve functioning of democratic institutions, including direct assistance to one of the worst-functioning democratic institutions -- the judiciary. (We do not rule out involvement in elections should opportunities present themselves, but the sensitive Philippine relationship with the former "colonial power" makes this sensitive and hard to plan for.)

1. Voice. A major emphasis is the development, and strengthening of institutions and organizations outside the government which can play an advocacy role. The private sector remains the primary engine of growth. USAID is planning institutional development support through the IRIS project to private-sector organizations that are advocating legal and administrative reform, particularly with regard to the informal sector. USAID is pursuing greater assistance to develop the capability of PVOs/NGOs, building on the program's sustainability and the PVOS' expanded role as emissaries of change in areas such as environmental policy.

In agribusiness, where major activity is expected in the near future, USAID is working with chambers of commerce and industry, to assist them to analyze issues affecting the agriculture sector and to interact effectively with the GOP. USAID is identifying other private sector groups for assistance, particularly in natural resources, agriculture and local development, to increase their ability to influence government policies that affect a market economy on behalf of their constituents.

2. Governance. Encouraging decentralization is another focus of the program. USAID's efforts emphasize a strong role for the private sector in meeting the growing demand for local development, and encourage a more efficient allocation of responsibilities between the national and local levels for the delivery of goods and services.

In FY 1990, USAID will begin a major program with the Asia Foundation for strengthening the judicial branch of government. Major components of the program are continuous trial training for judges and court personnel, training in alternative dispute resolution, and support to organizations which promote access to justice for disadvantaged groups. USAID expects to have in place a major democratic pluralism activity, focused on administration of justice among other things, during the Strategy Statement period.

Finally, to support choice in the electoral process, USAID may provide assistance for the 1992 elections, keeping in mind political sensitivities.

C. Women in Development

There appears to be a high degree of openness in Philippine culture for women to actively participate in various aspects of community life, in the economic sphere, and in political and civic organizations. Although historical data show female participation has not always been as intense or widespread as today's, available information indicate significant changes. For instance, in the political sphere and community leadership structure, not only are women more involved in the electoral process, recent trends indicate that an increasing number of women are contesting political positions in all levels of public offices.

Integration of women in economic processes has antecedents in agricultural areas and among the poorer sectors of society. For instance, studies of poor rural households show that both female and male members play crucial roles in acquiring and generating resources in order for the household to survive.

Statistics show that Filipino females are at par with males in school attendance, literacy and education and attainment. Further, the general trend towards a predominance of females in practically all levels of education and all fields of higher education may indicate that women have more advantages over men in this area.

The GOP's support for the goal of integrating women in the development process is clearly expressed in the Philippine Development Plan for Women (PDPW) 1989 - 1992, the primary purpose of which is to translate the country's development goals into concrete policies, programs and actions that address the poor and the disadvantaged not only on the basis of class, ethnicity or region, but in terms of gender as well. In addition, there are bills in the Philippine Congress that seek to improve women's participation and contribution to economic growth.

Studies have shown that attitudes toward male-female roles and the Filipino's assessment of equality between the sexes are based on the husband as family provider and the wife as home-based, providing only a support role. Financial need is perceived as the chief justification for a wife's taking a job. Apparently, not only the man but also the woman defines the wife's role as that of staying "at home". Although still valid, this cultural norm is slowly being eroded by better education, greater access to information, and the demands of economic survival Furthermore, social mores do not preclude the wife from active participation in politics and community problems.

The socio-cultural and political milleau within which the Mission operates is generally non-resistant to integration of women. The government's initiatives in this area also suggest strong political will to further dissolve social and economic barriers to women's involvement in development activities. This positive environment suggests that the Mission need not pursue activities geared towards attitudinal and value changes regarding the role and perception of women, and that the Mission need not initiate women specific projects.

It does suggest that the Mission's WID efforts should focus on better understanding of the dynamics of women's participation in current USAID funded activities to better understand the impact of women's participation in project performance. The Mission has initiated efforts to document the impact of women's involvement on project performance. The recently completed study on Women and Men in Rainfed Farming Systems and the on-going study on Effects of Women's Employment in the Formal and Informal Sector on Their Status and Fertility are examples of such efforts. Similarly, as the Mission moves away from project assistance type activities, it also must begin to study how best to integrate gender concerns in these efforts.

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